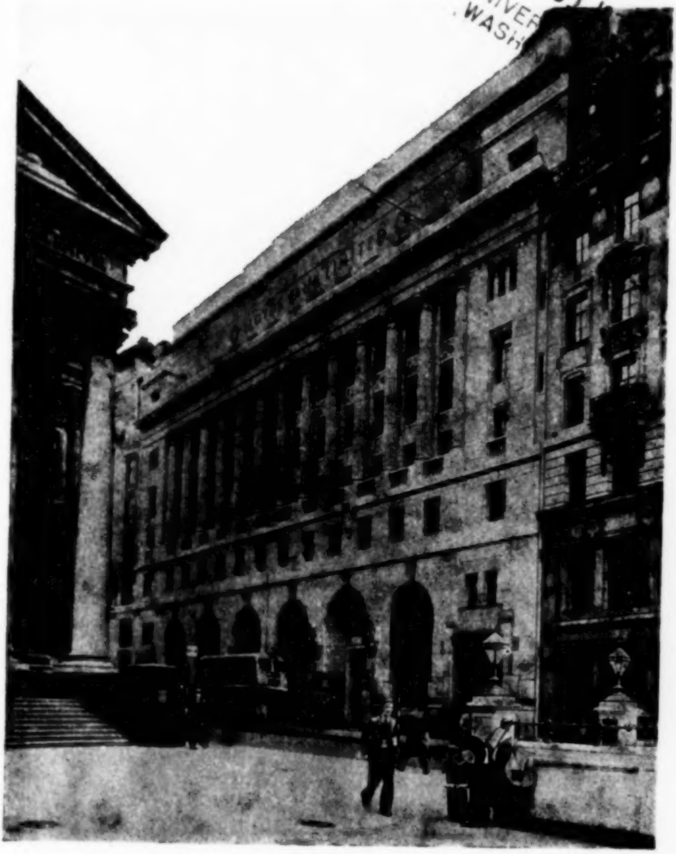

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The Bank publishes from time to time in this Review *signed articles by exponents of different theories on questions of public interest. The Bank is not necessarily in agreement with the views expressed in these articles. They are published in order to stimulate free discussion and full inquiry.*

Prospects for Closing the Dollar Gap

*By August Maffry**

WHAT has come to be called the "dollar gap" is variously defined. The essence of the concept is simple, however. It is the apparently persistent tendency for payments by foreign countries to the United States, or the demand for dollars, to exceed payments by the United States to foreign countries, or the supply of dollars. Some who use the term define it as the excess of exports over imports of goods alone or of goods and services combined. A more sophisticated and perhaps more logical definition would include among payments by the United States, along with payments for imported goods and services, also remittances to foreign countries by residents of the United States and investments abroad by private American investors. Indeed, a good case could be made out for considering the investment of dollar funds through the Export-Import Bank and the International Bank for Reconstruction and Development as a part of the usual supply of dollars to foreign countries to be taken into account in reckoning the dollar gap.

Under the first definition of the dollar gap as the simple surplus of exports over imports of goods and services, the gap during the past five years ranged from $6,700 millions in 1948 to $2,300 millions in 1950. If private remittances, private investment and investment through established U.S. Government and inter-governmental institutions are included in dollar supply, the range was from $4,800 millions in 1949 to only about $400 millions in 1950.

Now it is elementary that the dollar gap could have persisted during the post-war period only because there was available the means of financing it. The principal means, of course, was the aid extended in various forms by the U.S. Government to foreign countries. Since the beginning of the Marshall Plan in 1948, the amount of this aid has exceeded the dollar gap (under the second definition given above), with the result that foreign countries have been able to secure, in their transactions with the United States in each of the years 1949–51, a net addition to their combined holdings of gold and dollar assets and will probably be able to do so again in 1952.

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* *As Chief of the International Economics and Statistics Unit of the U.S. Department of Commerce, Dr. Maffry supervised the production of the well-known report "The United States in the World Economy," which was reprinted by H. M. Stationery Office in 1944. In the following year, Dr. Maffry joined the Export-Import Bank as Vice-President and Economic Adviser, and at the end of 1947 took up his present position as Vice-President of the Irving Trust Company.*

The dollar gap has not involved, therefore, any drain on the total external reserves of foreign countries. There have been at times, however, heavy drains on the external reserves of certain countries and groups of countries, notably the United Kingdom and the sterling area in 1947, 1949 and 1951. In other words, despite the large amount of dollars made available to the rest of the world by the United States under its post-war foreign assistance programmes, the dollar resources of many countries, including countries of great importance in international trade, have been subjected to severe pressures, with the consequence that restrictions on dollar payments for goods and on other accounts have become well-nigh universal and with the further consequence that the post-war goal of free exchanges and free convertibility is now perhaps more remote than it was in 1946.

It is precisely because of these restrictions and because of the inconvertibility of foreign currencies generally that so much attention is given to possible ways of closing the dollar gap. The advantages to the United States and other countries of achieving this purpose are self-evident (except, of course, to those who would like to maintain trade and exchange controls as a necessary part of a general system of government direction of economic activity). For the United States, it would mean lifting the burden of various forms of assistance to foreign countries and giving much greater freedom to American exporters in seeking foreign markets. For foreign countries it would mean relief from onerous trade and exchange restrictions and from the many internal regulations and controls required to make these restrictions effective.

What, then, are the prospects for closing the gap, first, by increasing the supply of dollars either on current account or on capital account, and, second, as a less desirable approach, by reducing the demand for dollars? There is the related question of stabilization loans by the United States to foreign countries as a means of consolidating a new equilibrium between the demand and supply of dollars in the event it should prove possible to close the dollar gap.

INCREASING IMPORTS OF GOODS

There is an obvious and close connection between the level of industrial production in the United States and the volume of imports of crude and semi-manufactured materials for industrial use. There is a significant relationship also between the total real value of goods and services produced in the United States (i.e., gross national product—GNP—at

constant prices) and the volume of imported primary materials, for the reason that the volume of industrial production is the principal ingredient of GNP.

The relationships between GNP and other imports, which consist of crude and manufactured foodstuffs and other manufactured products, are not so close. As Adler, Schlesinger and Van Westerborg have shown in their recent study,[1] factors other than variations in income must be found to explain changes in the volume of U.S. imports of food and finished manufactures. In the case of finished manufactures especially, relative prices appear to be a much more important influence than previous studies have indicated.

Nevertheless, largely because crude and semi-manufactured materials constitute three-fifths of total U.S. imports, there is a significant relationship between real GNP and the total volume of U.S. imports. It is possible, therefore, to project, although not without qualification, the prospective increase in American imports on the basis of given assumptions regarding the growth of the American economy. For this purpose, we may take the assumptions made by the President's Materials Policy Commission in its recent report to the President:

> . . . the rate of growth of the economy in the next 25 years will be neither more nor less than what it has averaged over the last century, or about 3 per cent. per year. Three per cent. compounded results in a doubling every 25 years; thus, by 1975 our total output of goods and services (the Gross National Product or GNP) is assumed to be twice what it actually was in 1950.

If this assumption is accepted, it may be inferred that U.S. imports in 1975 will be roughly double what they were in 1950, or \$18–19,000 millions at 1950 prices. (At *current* prices, U.S. imports were \$11,700 millions in 1951 and will be about the same in 1952.) It does not follow, of course, that this prospective increase in dollars supplied by the United States to foreign countries as GNP increases will be devoid of cyclical or erratic fluctuations. For example, a downward fluctuation might come if, as some economists predict, there is a falling off in the level of economic activity in the United States when the scheduled tapering off of the rearmament programme begins at the end of 1953 or the early part of 1954. There are too many imponderables involved in this forecast, however, to make it more than a sheer speculation. For one thing, there is no certainty that the defence preparations of the

[1] *The Pattern of United States Import Trade Since* 1923, Federal Reserve Bank of New York, May, 1952.

United States and of the Western world generally will in fact decline at that time, or earlier, or later. For another thing, there is no sure way to appraise the weight of such factors as the backlog of postponed public works in the United States, the backlog of delayed improvements in industrial plant and equipment, or the unprecedented accumulation of savings in the hands of the public.

A better method of estimating the future course of American imports would be to examine import potentials on a commodity-by-commodity basis, taking into account both historical relationships and price and other factors likely to affect the physical volume and unit value of individual import commodities. One of the major factors to be taken into account would be the progressive depletion of the raw material resources of the United States and the consequent increased dependence on foreign sources. The depletion of reserves of iron ore and of non-ferrous metals is, perhaps, the most conspicuous case in point, but there are many others.

The Materials Policy Commission in its recent report to the President presented impressive evidence that there is in prospect a world shortage of industrial raw materials and one which will be particularly acute in respect of industrial metals. There is also the prospect that the prices of industrial raw materials will tend to rise and that the price factor affecting U.S. imports will be a factor tending to increase their total value. This outlook will be reassuring to the countries producing metals and other primary materials but will be of small comfort, naturally, to the countries of Western Europe; they will find themselves in the position of competing with the United States for an increasingly short supply of raw materials and of not sharing, except perhaps indirectly through their investments in overseas areas, in the dollar income produced by American purchases at rising prices.

The inauguration this year of so-called "off-shore procurement" by the United States in European countries of supplies and equipment for American and other NATO forces introduces still a new source of dollar supply to foreign countries and one which should be regarded as not necessarily temporary. So long as the defence preparations of the United States continue under forced draft, and so long as there are available industrial capacities in European countries, the expedient of off-shore procurement will probably be used. Its importance is considerable, as measured by the fact that, as of July, 1952, orders totalling $700 millions had been placed in European countries by the United States for delivery against dollar

payment. It is quite conceivable that by this technique European countries will be able to earn as much as \$1,000 millions annually for a number of years by producing military goods for the United States and her partners in NATO.

On the other hand, there must be taken into account, as a factor tending to decrease the supply of dollars to foreign countries, the substitution of synthetic products for imported raw materials. A past example is the almost complete substitution of synthetic fibres for silk. An important current example is the partial displacement of natural rubber by synthetic rubber. Future examples may be the replacement of wool by synthetic fibres and of metals by plastics.

REDUCING TRADE BARRIERS

Not much can be expected by way of further reductions in trade barriers as a means of increasing U.S. imports. As regards reductions in tariffs under the terms of trade agreements, practically all of the concessions of any importance which might be given to the United Kingdom and Western European countries have already been given under existing agreements. Further reductions would be possible only if a new Administration in Washington asked for and obtained from Congress increased Presidential authority to reduce tariffs, either by the trade agreements technique or by some other technique. On the other hand, imports from Western hemisphere countries and from Africa and Asia consist very largely of raw materials and are already for the most part on a duty-free basis.

In addition to these technical limitations on further reductions in the U.S. tariff, there are evident pressures for increases in duties on a number of imported items. There has been a notable rise in the number of applications to the Tariff Commission for increases in duties, under the provision of the Trade Agreements Act providing for relief to domestic industries adversely affected by reduced tariffs under trade agreements. Some of the commodities involved are fairly important, as, for example, Swiss watches and British motor cycles. In the British motor cycle case, the Tariff Commission refused to recommend an increase in tariffs. In the Swiss watch case, which is the most important of all of the pending cases from the point of view of the value of imports involved, the Commission did recommend an increase in duty but the President rejected its findings.

Other less important cases have included hatters' felt fur, blue-mould cheese, wood screws, dried figs, garlic, spring

clothes-pegs and groundfish fillets. The Commission recommended withdrawal of the duty reduction on hatters' felt fur, and this was done. In the case of blue-mould cheese, it rejected the application for restoration of higher duties but observed that it might have acted otherwise if imports had not been limited by quotas under the Defence Production Act. The wood screw application was first rejected without an open hearing. Then hearings were held on a new application, and a decision is pending. The Commission recommended an increase in the duty on dried figs, and the President concurred. It also recommended an increase in the tariff on garlic, but the President disapproved. It rejected the applications for higher tariffs on spring clothes-pegs and groundfish fillets. Of eight cases adjudicated to date, the Commission has rejected four petitions for increased duties and approved four. The President has concurred in two of the Commission's approvals and rejected two. Twelve cases are pending under the escape clause, and three additional cases under other provisions of law. Such is the record.

Two things should be borne in mind in connection with these proceedings before the Tariff Commission. One is that the Commission is bound under the terms of the Trade Agreements Extension Act of 1951 to recommend an increase in duty if it finds that a domestic industry is injured or stands to be injured as a result of a reduction in duty under a trade agreement. In other words, the policy is laid down by Congress, and the Commission is restricted to a finding of fact. The second thing is that the Commission is bipartisan, with three members each from the two major parties. Two of the present Republican members consistently favour giving protection to domestic producers. Two of the present Democratic members consistently oppose giving them protection. The remaining two members, one a Republican and one a Democrat, are not so consistent, and, by virtue of their inconsistency, hold in effect the balance of power in the Commission. Needless to say, the predilections of prospective appointees to the Commission are carefully weighed by the President, who appoints, and the Senate, which confirms. One member of the Commission, a nominal Republican, is retiring and will be replaced, as required by law, by another Republican.

Besides the spate of applications to the Tariff Commission under the escape clause in the Trade Agreements Act, Congress has acted recently to place quotas on imports of specified commodities. In an amendment to the Defence Production Act (having nothing to do with imports or trade restrictions),

Congress provided that quotas be placed on the importation of certain agricultural products, notably cheese. Under strong Administration pressure, this measure was somewhat relaxed at the last session of Congress, but the quotas remain. A move to restrict imports of fresh and frozen tuna failed in the last session of Congress. This followed an increase in the tariff on tuna in oil as a result of the cancellation of the trade agreement with Mexico.

A Customs Simplification Act was introduced into the 81st Congress partly for the purpose of removing some of the administrative obstacles to imports into the United States and would have had the effect, by a redefinition of import values, of reducing duties payable under *ad valorem* tariffs. Having failed of passage, it was reintroduced—stripped of some of its more controversial features—in the 82nd Congress, and was passed by the House of Representatives. It died in Senate committee, largely because, in the press of legislative business just prior to the political conventions in July, not enough time was available for its consideration. There is every intention on the part of its present sponsors to reintroduce the bill at the next session of Congress. This plan may be altered, of course, by a new Administration in Washington.

In the meantime, the awarding to the Ferranti Electric Works in the United Kingdom of a contract on a public works project in North Dakota has come along as the first important exception made under the terms of the Buy America Act. This Act, which dates from the depression period of the early 'thirties, provides for preferential treatment of American material in Federal contracts for public improvements. It provides also, however, that exceptions may be made by the responsible government official if he finds this preferential treatment to be inconsistent with the public interest or the cost of American materials to be unreasonable. In the Ferranti case, the Secretary of Defence found that the cost of American equipment was unreasonable in comparison with the bid made by Ferranti and accordingly awarded the contract to Ferranti.

The Ferranti case sets an interesting precedent, but its importance should not be exaggerated. In order for exceptions to be made under the Buy America Act, the difference in cost between American and foreign materials has to be very considerable, and it may be doubted that there will be many instances in which the differential will be sufficiently large to justify a finding by an official of the executive branch contrary to the expressed general policy laid down by Congress. The only way to put American and foreign materials on an even

footing as regards public works in the United States would be to repeal the Buy America Act, as has been recommended recently by the President's Materials Policy Commission. The Commission characterized the Act as "born of depression psychology" and urged that it be repealed in order to enable the United States to obtain the materials which it requires at the lowest possible cost.

The actual increase in U.S. imports which can be attributed to reductions in the American tariff and other trade barriers during the past two decades is certainly small in relation to the cyclical and secular increases during the same period. So also is the potential increase which might result from further reductions in these barriers. This is not to minimize, however, the importance of lowering the barriers from the point of view of particular foreign countries, especially those supplying finished manufactures to the American market.

INCREASING IMPORTS OF SERVICES

There is also the possibility of increasing the supply of dollars to foreign countries by increasing imports of foreign services by the United States. Not much can be expected in this direction, however, as regards shipping services or tourist expenditures. As matters stand, the United States earns more by the sale of shipping services to foreign countries than it pays to foreign countries for shipping services which they render to the United States. The surplus of receipts over payments by the United States on ocean shipping account in 1951 amounted to more than $600 millions. This situation exists for a number of reasons. Direct subsidies by the U.S. Government to the American merchant marine are a factor. So, also, are the stipulations in foreign aid legislation regarding the use of American ships, as, for example, the requirement that U.S. flag vessels carry at least half of the shipments from the United States financed by the Economic Co-operation Administration and its successor, the Mutual Security Administration. The predominance of the American tanker fleet, which is not subsidized, is still another factor. Finally, the export surplus of the United States itself tends to produce a surplus of shipping receipts over shipping payments.

Tourist expenditures, on the other hand, do yield a net supply of dollars to foreign countries, although both the actual amount and the potential increase in the amount are frequently exaggerated. Moreover, the bulk of the expenditures by American tourists in foreign countries is made in Canada and Mexico, rather than in overseas areas. Total expenditures

in overseas areas in 1951 amounted to only $300 millions and were substantially offset by expenditures by overseas visitors to the United States, estimated at $150 millions. Projections of expenditures of American tourists in foreign countries based on past relationships to income are subject to serious qualification. For one thing, the declining number of foreign-born residents in the United States has a great influence on the number of persons travelling to overseas countries.

There is another category of service payments by the United States to foreign countries which is, at least for the time being, on a high and rising level. These are payments occasioned by the defence activities of the United States in foreign countries, including expenditures by American military personnel in these countries. Service expenditures by the armed forces of the United States and their personnel are running in 1952 at a rate in excess of $1,000 millions, and there are in addition payments by non-military agencies which will amount to $250 millions. These dollar expenditures outside the U.S. constitute a major source of dollar income for Japan, an important source of income for the Philippines and Germany, and a minor, although not inconsiderable, source of income for other countries, including the United Kingdom. So long as the present strained international situation exists, it is to be expected that these expenditures will continue and even increase for a time. If one assumes an indefinite continuation of international tension, they could become a permanent and an important contribution to the supply of dollars to foreign countries.

INCREASING PRIVATE INVESTMENT ABROAD

The prospects of any great increase in private U.S. investment in foreign countries are not very bright. The amount of such investment during the post-war years has ranged between 700 and 1,700 million dollars annually, including the reinvestment of earnings in foreign countries. A large proportion of this post-war investment has been special purpose investment and chiefly of two types. There have been large investments by American oil and other companies for the purpose of opening up new sources of raw materials in foreign countries and, in the case of the oil companies, for building refineries. Other companies, especially manufacturing companies, have made substantial investments, in continuation of a trend which became evident during the 'thirties, in order to maintain or secure markets in foreign countries which would otherwise be closed to them because

of trade and exchange restrictions. These two types of special purpose investment will undoubtedly continue in considerable volume, although it appears that the investment of new money abroad by the American oil companies may have already passed its peak.

On the other hand, there has been since the recent war very little of what might be called general purpose investment abroad by American investors, that is, investment for the sake of getting a higher return on capital than can be obtained in the United States. The virtual absence of publicly-offered foreign issues, except Canadian issues, in the American market attests to this fact. There are other forms of general purpose investment in foreign countries by American investors, but none of any present or prospectively great importance.

The generally agreed desirability of increasing private American investment abroad in order to further national economic and political objectives has caused considerable agitation in both government and private circles in the United States to create extraordinary stimulants to such investment. The stimulants provided or proposed are of three kinds: (1) bilateral treaties between the United States and individual foreign countries carrying mutual assurances of fair treatment of foreign investments; (2) investment guaranties extended by the U.S. Government against certain risks peculiar to foreign investment; and (3) tax concessions by the U.S. Government in favour of American investors in foreign countries.

The treaty programme, which was set on foot in 1948, has made slow progress, and there are many who doubt that it is a really effective means of improving the climate for American investment in foreign countries. It is argued that, if conditions of investment are favourable, as they are, for example, in Canada or the United Kingdom, no formal agreements are necessary. On the other hand, if the attitude of foreign countries towards private investment is dubious or hostile, no form of treaty will serve to reassure potential investors; only satisfactory performance with respect to treatment of outside investors will serve. It is contended further than an investment treaty programme, even on a bilateral basis, will tend towards the "lowest common denominator," since official negotiators for the United States are not in a position to exact from any country assurances which they could not expect to get from others. Finally, some at least of the major American corporate investors in foreign countries believe that they can do better on their own resources in obtaining satisfactory assurances of fair treatment. The recent successful

negotiations between the Government of India and the oil companies with respect to investments in refining facilities in India constitute a case in point.

The guaranty programme is on the statute books in the form of an authority given to the Director of Mutual Security to extend guaranties against the risks of inconvertibility and expropriation. These guaranties are available to all new dollar investments in countries eligible to receive aid from the United States under the Mutual Security Programme. It is doubtful, however, whether the guaranty programme will provide an important stimulus to new investment abroad. The amount of investment guaranteed with respect to convertibility risk under previous legislation (which was more restricted as to eligible countries) was quite small, and some of the investments involved would undoubtedly have been made without the guaranty. The cost of the available guaranties, at 1 per cent. per annum of the guaranteed amount for each of the two types of coverage, is often high in relation to anticipated returns. Furthermore, no protection against war risk is afforded. Finally, there are many potential investors who shrink from submitting their plans and, if a guaranty contract is entered into, their accounting methods to the scrutiny of a government agency.

As regards tax concessions, there have been some changes in revenue laws for the purpose of removing inequities and anomalies in the application of these laws to income on foreign investments; but there has not been, nor is there in prospect, any major concession to investors abroad such as would provide a powerful stimulus to general purpose investment by American investors in foreign countries.

In the absence of effective stimulants of the kinds just described, any increase of private U.S. investment in foreign countries will depend upon the removal of existing obstacles to investment abroad. These consist of unfavourable conditions of investment, uncertainties regarding the transfer of earnings and the repatriation of capital and, perhaps most important of all, the strong counter-attraction of high-yielding investments in the United States. As to the first of these obstacles, it is difficult or impossible to generalize, since the climate here improves (e.g., India) and there worsens (e.g., Iran). As to the second, while it may be argued that the transfer difficulty is for various reasons much less formidable than it was before the war, restrictions on transfer do exist in many countries and serve to sustain doubts in the minds of potential investors. As to the third, which is the counter-attraction of domestic

investment, there is no reason to believe that the situation will change either absolutely or in relation to prospective realized returns on foreign investment. In sum, therefore, there are no secure grounds for believing that private American investment abroad will increase notably from the level of recent years.

GRANTS-IN-AID

The existing dollar gap is being filled largely by grants-in-aid extended by the United States to European and other countries. These grants are now of two types. There are, first, economic aid to European countries, labelled "defence support" assistance and, second, economic and technical aid to countries in the Far East, the Middle East, Africa and Latin America. The amount authorized for economic aid to European countries during the current fiscal year was fixed by Congress at $1,300 millions and the amount of economic and technical assistance to other countries at $350 millions. All of this is in addition, of course, to military aid to Europe and other countries, which was authorized in the amount of $4,200 millions. Military aid is left out of account for present purposes because its contribution to closing the dollar gap is at best indirect, in the sense that the United States, by providing military equipment and supplies to foreign countries, may reduce their dollar import requirements (or increase their export potentials) under their commitments to the common defence.

It is conventional to regard economic assistance by the United States to foreign countries as extraordinary and temporary. This is no doubt the intention and hope of both donor and most of the recipients of American aid. Even so, it is an arresting fact that economic assistance on a substantial scale has been extended by the United States to foreign countries in every year since the end of the war and, for the most part, avowedly for the purpose of bridging the dollar gap. There is clearly increasing resistance in the U.S. Congress to the continuation of economic assistance as such to European countries in the face of evidence that most of them have regained or surpassed pre-war levels of production and consumption. Indeed, economic assistance to European countries during the current fiscal year was justified, as its label "defence support" implies, almost entirely on the ground that it was necessary in order to enable the NATO countries to make their due contribution to the common defence effort. On the other hand, economic and technical assistance to so-called under-developed countries under the Point IV

concept has increased many-fold from modest beginnings in 1950 to $350 millions in 1952. In view of the considerable popular and Congressional support of the Point IV programme, it is entirely possible that this form of aid will become a permanent addition to the international supply of dollars. Here again, however, the direct beneficiaries will be, not the industrialized countries of Europe, but the under-developed countries of Asia, Africa and Latin America.

REDUCING DOLLAR DEMAND

Whatever may be the prospects for increased dollar supply, the supply will be insufficient if the demand for dollars in foreign countries is not kept in check by appropriate fiscal and monetary measures or, this failing, by direct controls. There can be no doubt but that the persistence of the dollar gap during the post-war period is to be attributed more to inflation-fed demands than to deficiency of supply, for the supply of dollars has been on a high and rising scale. The simple fact is that foreign countries collectively have not lived within their aggregate dollar income or, more accurately, have used up the normal supply of dollars plus an extraordinary addition in the form of U.S. Government assistance and still failed to meet the demand generated by inflated national incomes.

There are many reasons for this state of affairs, including requirements of reconstruction, full employment policies and related easy money policies, lax administration of revenue laws and undue reliance on direct controls. The examples of countries which have by orthodox fiscal and monetary measures reduced or eliminated inflationary forces and thereby reduced the demand for dollars are instructive and heartening. These examples have demonstrated—what it should not have been necessary to demonstrate in the light of monetary history—that internal monetary stability and equilibrium in the balance of payments are inseparable. In the light of the new evidence cited above of the importance of relative prices in determining the volume of U.S. imports of finished manufactures, it is worth emphasizing that the same monetary policies appropriate to limiting the demand for dollars are conducive also to increased sales to the American market.

STABILIZATION LOANS

In principle, the closing or prospective closing of the dollar gap sets the stage for stabilization operations in the form of dollar loans or lines of credit to selected countries. If in the form of loans, these operations would serve actually to augment

monetary reserves and, if in the form of lines of credit, would give access to additional reserves in case of need. They would in either case serve, by restoring and increasing confidence in non-dollar currencies, to consolidate a newly-won equilibrium in the international payments of foreign countries. It is in the nature of genuine stabilization loans or credits that, if they are expected to be used, they cannot be justified, while, if they are not expected to be used, they are needed only as show pieces to restore and maintain confidence.

The basic purposes of stabilization operations which might be undertaken by the United States directly or through one of the international institutions of which it is a member are the same as those of closing the dollar gap. The fundamental purpose is freer trade through the removal of trade and exchange restrictions and through the free convertibility of currencies. It may be taken as certain that stabilization operations to which the United States is a party would become practical possibilities only if these *desiderata* constitute the consideration for American assistance. In other words, the actual relaxation of trade restrictions and convertibility would have to precede or accompany the undertaking of stabilization operations. The mere prospect of achieving these goals would not be enough.

Stabilization operations of a multilateral character are presumably not in question except to the extent that the International Monetary Fund with its existing resources may be considered to provide such a facility. It would be the duty and avowed purpose of the Fund to make its resources available, always with limitations, in support of the currency of a member undertaking to relax exchange restrictions or to restore convertibility. However, while the Fund's existing resources, under the statutory and conventional limitations on their use, might suffice for stabilization operations involving minor currencies, they would scarcely meet the need in the case of a major currency such as sterling. Those who envisage stabilization operations as the climax of post-war international monetary reconstruction must think, therefore, in terms of large-scale operations outside the Fund directed towards the stabilization of key currencies, with sterling in first rank of importance.

If, from this point of view, the facilities of the Fund are ruled out as probably inadequate, there remain the possibilities, first, of using the existing facilities of the International Bank or the Export-Import Bank or, second, of obtaining new Congressional legislation specifically authorizing stabilization operations. These possibilities will be examined in turn.

The International Bank has clear authority to make stabilization loans, thanks to an interpretation stipulated by the American Congress in its approval of the Bretton Woods agreements. Whether the International Bank would undertake large-scale stabilization operations is, nevertheless, seriously open to question. The Bank has used up its loanable paid-in resources and would be obliged to obtain large sums in the private market in order to make stabilization loans. Furthermore, the International Bank has become, since the close of the reconstruction phase of its operations in 1947, exclusively an international development bank. All of its efforts are directed towards development objectives, and its borrowing capacity in the private market is undoubtedly reserved in the minds of its officials and principal sponsors for long-range development financing.

The Export-Import Bank, on the other hand, could much more readily contemplate a stabilization credit to, for example, the United Kingdom. Its powers are adequate and its uncommitted resources quite large, while the scope of its functions is more and more circumscribed by the broadened activities of the International Bank in the development field and by other circumstances. In view of the evident confidence reposed in the Bank by members of Congress of both major parties, it would no doubt be possible for the Export-Import Bank, if it should be necessary or desirable, to obtain from Congress specific authority to extend a large stabilization credit to the United Kingdom or even to obtain an increase in its lending authority for this purpose.

As regards stabilization operations under new legislation, there is, of course, the possibility of a " second British loan " ; but, under the circumstances attending the first loan, it is difficult to believe that this is more than a remote possibility. There would be a much better chance of obtaining authority from Congress, as a part of the annual legislation authorizing foreign aid, to use some of the authorized funds for stabilization operations. This has been strongly urged in fact by one of the leading American business organizations. The authority given in foreign aid legislation in recent years to allocate funds to a European payments scheme constitutes a precedent of a sort. At any rate, if a stabilization operation becomes practical politics, it is more than probable that authorization of this kind would be sought rather than separate legislation authorizing a stabilization loan.

There remains the possibility of raising the dollar price of gold in order to increase the dollar value of the gold reserves

of foreign countries and thereby assist them in stabilizing their currencies. An increase in the dollar price of gold would require action by the American Congress. The Executive Branch of the U.S. Government is clearly not disposed, however, to recommend an increase. On the contrary, there is vigorous opposition to the idea, and there is every indication that Congress would not approve a change even if the Executive Branch were to recommend it. These attitudes are attributable in part to a strong sentiment against "tampering with the price of gold" and to the presumed inflationary consequences of debasing the currency. Furthermore, the benefits of a higher dollar price, as determined by existing gold reserves and new production of gold, would not be distributed in any close relationship to the need for stabilization assistance and, however distributed, would probably be inadequate as well under any reasonable assumption regarding a higher price for gold. If stabilization operations are contemplated, therefore, other means of augmenting the monetary resources of foreign countries will undoubtedly be considered more effective and cheaper. In any case, an increase in the dollar price of gold is simply not now a practical possibility in the United States.

It is worth repeating that stabilization operations to which the United States is a party will not become feasible unless the dollar gap is effectively closed, in the instance either of the individual foreign country or of any group of countries. Countries which tend to run short of dollars have open to them a number of possibilities, more or less promising as already indicated, of increasing their receipts of dollars. It is to mutual advantage that none should remain unexploited. Aggressive sales efforts in the American market can yield significant results, as many post-war examples demonstrate. In the last analysis, however, the great hope of closing the dollar gap lies in the continued expansion of the U.S. economy and in the growing American demand for foreign materials, manufactures and services. Any country willing to keep the demand for dollars within bounds by appropriate monetary measures has time on its side in closing its own dollar gap.

AUGUST MAFFRY.

Irving Trust Company,
New York,
September, 1952.

The Price Policy of the National Coal Board

By S. R. Dennison

IN spite of their fundamental importance, the price policies of the nationalized industries have received but little attention. The Boards themselves seem to have neglected price problems in favour of more urgent matters. At first they were understandably pre-occupied with transfer of ownership and the immediate conduct of operations. Since then, they have paid more attention to the physical development of their industries, and to forms and methods of organization. Price policy cannot help obtruding itself at almost every point as an essential element of most other problems, but it is handled tentatively; some expedient which will deal with the immediate difficulty is adopted until such time as a new price structure can be worked out, in the light of all the relevant considerations. A search for any influence of economic thinking on the policies of the Boards yields meagre results.

The National Coal Board is now in the sixth year of operation, and it is still a long way from having introduced the "new and rational" price structure which, according to its *Annual Report* for 1947, was to be adopted "as soon as possible". Since then, there have been four further *Reports*, and a *Plan for Coal* (published October, 1950), and it is possible to trace the Board's communings with itself on a difficult and complex problem. It should be recognized at the outset that the Board inherited a difficult situation, and that the simple fact of nationalization itself introduced new elements of difficulty. Moreover, the Board has tried hard, and many of its original (and present) intentions were well-conceived. It is therefore the more unfortunate that its efforts seem likely to end in a price system which will do much to frustrate its main purposes.

II
CHARACTERISTICS OF THE COAL INDUSTRY

Three well-known features of the coal industry have an important bearing on prices and price policy.

First, "coal" is not a homogeneous product, but a series of different commodities, each with its own characteristics and specialized uses, and its own demand and supply

conditions and markets. Before the war, this resulted in a wide range of prices; at the end of 1937, for example, South Wales large steam coal was selling at 23s. a ton, Durham gas coal at 19s. a ton, and Fifeshire steam coal third class at 16s. 6d. a ton.

The second feature is the wide range of efficiency between the different producing units. Geology and age are added to the other factors which cause disparity in productive efficiencies. The Samuel Commission of 1925 observed that costs per ton ranged from 12s. to 30s. at different pits, and even this did not fully represent the variation in productivities in physical terms. In broad terms, the *districts* with high productivity now have an average output per man-shift about double that of the low-productivity districts; the range between pits at the top and bottom of the scale is even greater. In 1951, the average costs per ton of output (excluding interest charges) in the Cumberland Area came to 69s. 8d., whereas in the South Derbyshire Area they were 33s. 5d. In this type of industry, the closing down of old workings as they become too expensive to operate, and the opening up of new pits, is an essential part not merely of any increase in average efficiency but of the maintenance of the existing level.

Thirdly, the product is costly to transport in relation to its value; and as the industry is localized, a substantial part of the final cost to the consumer can consist of transport charges. In 1951, the average charge for coal carried by rail was over 10s. a ton, equivalent to about one-fifth of the pithead costs, a proportion which does not seem to have varied much in the past quarter of a century. The consumer, in fact, buys coal plus transport, and would normally wish to purchase that combination of production plus transport which gives the lowest total price; low transport charges help to offset high production costs, and high transport charges balance low production costs. The importance of transport costs is such that the factor of distance can often be of greater significance than differences in productive efficiency.

The Samuel Commission observed that some of the pits which had the highest costs also had the highest proceeds (i.e. receipts at the pithead). The reason was that they were supplying either a higher quality of coal (e.g. anthracite) or a local market, or possibly both. It was these conditions which kept them going. Even if coal were all of the same quality, there would still be advantages of location; a pit with high production costs could still compete effectively in its own local

market against pits with low production costs which were further away, while the lower a pit's production costs, the larger the area over which it could compete.

III
THE FUNCTIONS OF PRICES

In a free market system, it is to prices that we look to govern the pattern of consumption and production, and to stimulate those continuous adjustments which are inevitable in a world of change. On the one hand, the consumer will be seeking to buy the qualities and quantities he wants at the lowest possible prices; he will adjust both quantities and qualities, and change his sources of supply, in response to changes in relative prices. Before the 1930's, there was a highly competitive market in coal, and large consumers were very much aware of the opportunities offered by changes in prices, as were the large merchants who supplied the smaller consumers.[1] On the other side, producers strive to meet the market demand, to keep their costs as low as possible and to expand their sales; those who are most successful in keeping down costs will be able to extend their market, those who are least successful will decline and eventually close down. It is in this way that the whole complex pattern of production and consumption is determined.

This pattern is, moreover, far from static, but is in constant process of change; equilibrium is never reached, the system is always on the move. A change in the demand for steel, for example, affects the demand for coking coal, and this could lead to significant shifts in the pattern of coal prices and production. Or a change in the relative costs of rail and coastwise transport could materially affect the competitive position of different pits and coalfields in, say, the London market for household coal. Then there is the supreme importance of the gradual exhaustion of existing sources of supply and the need to replace them with newly-opened workings; even in a completely static environment, the coal industry would still show, over the years, big changes in efficiency and location.

It is an important feature of a free market that the necessary changes are brought about through decentralized decisions. It is the individual consumer who decides to change his source of supply; it is the decision of an individual colliery to exploit a new opportunity which may provide some consumers with

[1] See, e.g., Evidence of the National Gas Council before the Samuel Commission (Minutes of Evidence, Vol. 2, Part A, p. 167, paragraph 10.)

a new alternative source of supply. The market is the instrument whereby these individual decisions are given collective effect, but it operates without any need for centralized action.

The commercial history of the coal industry since 1930 is essentially one of the progressive abandonment of this kind of free market. Before the Board's policy can be understood, it is necessary to take a brief glance at these earlier years.

IV
THE YEARS 1930-1947

Under Part I of the Coal Mines Act of 1930, there was established a compulsory cartel, with a Central Council to allocate output among the different Districts and District Boards to control matters in their own areas. Although this had been intended as a temporary measure, a " breathing space " to help the industry to carry through a reorganization which would increase efficiency, it proved to be a permanent policy. It is undoubted that it fulfilled its purpose of raising prices. At first, this was done by simple restriction of output, but there soon developed more complete control, with fixing of minimum pithead prices and direct limitation of competition between different pits and districts. The extent to which control had gone by the outbreak of war can be seen in one of a series of assurances given by the Central Council to the government in 1938:—

" Where a consumer desires to change his source of supply for a good and sufficient reason—*other than reasons of price*—the Sales Control Bodies do not and will not place difficulties in the way of the issue of permits for the coal desired if it is available ". (My italics.) An italicized explanation makes the reason clear: " In cases where consumers are attempting to set off one colliery against another in the matter of price, steps must be taken to prevent this if the objects of the Coal Mines Schemes are to be carried out ". The government accepted these assurances as satisfactory.

We are not here considering the case for or against a raising of coal prices in the 1930's (which also meant support for miners' wages, then very low). What is relevant is that the policy undoubtedly delayed the essential process of closing down inefficient and dying pits and hindered the development of more efficient and young mines. That this was happening was implicitly admitted in one of the arguments put forward as justifying the policy: that it helped to spread unemployment

more evenly among the different districts, instead of leaving it to be concentrated in the high-cost areas.

In the *Plan for Coal*, there are some data which show very broadly the effect on the range of costs. In 1930, 84 per cent. of the total output of the country was produced at a cost which was within a range of 12½ per cent. of the national average; 5 per cent. of the output was produced at a cost below, and 11 per cent. at a cost above, this range. By 1938, however, 76 per cent. of the total output was within this range, 24 per cent. above and none below.

The war carried the process further, by the introduction of the averaging principle to costs and prices, as a simple expedient to meet the disruption of normal commercial relationships and to prevent a rapidly rising level of costs from having its full effect on prices.[1] This was done through the mechanism of the Coal Charges Account. With each general increase in costs, the national price of coal was raised by a flat-rate amount equal to the increase in the national average costs per ton; the proceeds were then, in effect, divided among the pits according to their "needs." As costs rose, and disparities between pits and districts grew more marked, the amount of the subsidy to the less productive, and the "tax" on the more productive, continuously increased. By 1945, in very broad terms, the Midland Amalgamated District, responsible for some two-fifths of the national output, was carrying the rest of the industry.

This system had, of course, the same effect on development as the cartel of 1930. Stimulus to expand the more efficient, and to close down the less efficient, units was entirely removed. There were other limiting factors on development during the war, which was hardly a time to embark on the sinking of new mines; nevertheless this system was quite inconsistent with the generally accepted remedy for low output, that of concentrating on the more efficient pits and seams and closing down the others.

At the same time, there was a great *reduction* in the differentials between prices. The increases in national average costs were turned into flat-rate increases in prices, applying equally to all grades of coal. The average pithead price was increased by over £1 a ton, over a pre-war average price of 17s. to 18s. a ton. The result was that the poorer qualities had more than doubled, perhaps trebled, in price, whereas the

[1] For a full account of this, and other war-time changes, see W.H.B. Court, *Coal*, the volume in the Official Civil History of the War.

higher grades had increased by not much more than 75 per cent. It is clear that the lower grades were relatively overvalued, and the better grades undervalued. The normal market effects of this did not follow, because all grades were so scarce; complaints about qualities and prices were all that was open to the aggrieved consumer.

This was the situation when the National Coal Board assumed control on 1st January, 1947.

V
THE BOARD IN SEARCH OF A POLICY

The Board was quite aware that it took over an unhappy situation. In its first *Annual Report* (1947), it pointed out the defects of the war-time arrangements which, although "easy to administer", distorted the general structure of prices. It also announced that it intended to "introduce a completely new price structure for the industry as soon as possible". The Board was too optimistic, and underrated the complexities and difficulties of establishing a model of the market when the market itself has been abolished.

It is instructive to follow the process through the *Annual Reports*. This will be done chronologically, but it may be helpful at the start to indicate that there are three main strands, which are closely interwoven. First, there is the attempt (largely successful) to re-establish the differentials between the prices of various grades. Secondly, there is the reassertion of the principle that prices should be related directly to costs at the individual productive unit, and that averaging of costs, with accompanying subsidizing, is "undesirable as a permanent method of dealing with wide differences in production costs". Here the Board has been uncertain in its approach. Thirdly, there is the choice between fixing prices at the pithead, so that the consumer pays the pithead price plus actual transport charges, or fixing them as delivered prices based on pithead costs plus average transport costs. The former was the general practice, but the Board has moved towards the latter, and this is where it has gone most seriously astray.

The emphasis of the first *Report* (for 1947) is on restoring the differentials. The basis of the approach is technical, on the grading of coals by size and physical or chemical properties. We are informed that work on a standard grading is proceeding. It was, however, recognized that other factors must be taken into account in fixing prices, and that these would include the differing costs of production at, and of transport from, different places.

There is also some discussion of problems of development. The essential guide is to be profit or loss, either of which suggests that " the nation's resources are not being used to the best advantage ". It is not clear whether the Board intends to apply the criterion to individual pits or to whole coalfields. Although ambiguity of statement continues to the present time —the Board often using the meaningless phrase " pits or coalfields "—it seems that the intention is to continue a substantial degree of averaging. Thus, the objective stated in the *Plan for Coal* is that " in the long run, planned reorganization of the *coalfields* would make them all self-supporting or nearly so ". (My italics.)

By 1948, there are signs that the Board is finding the task rather difficult. The year started with a flat-rate increase of 2s. 6d. a ton on the price of coal, to cover the costs of a new wage agreement, and the war-time distortion was thereby further increased. The Board had thereafter intended to leave matters " until they could introduce an entirely new price structure for the industry ", but after consideration decided that " this cannot be done all at once or done soon ". They were helped by a new phenomenon, the reactions of consumers to high prices in a market in which the demand has ceased to be inelastic. It is reported that " in the summer of 1948 some of the poorer quality coal being produced could not be sold, while the demand for the better quality coal far exceeded the supply ". The Board therefore made its first adjustment in relative prices, reducing the lower grades by amounts up to 15s. a ton, " to encourage consumers to use more of them ", and increasing the better grades by about 3s. a ton, expecting to break even over the whole output. This was a substantial move, but it still left many anomalies " which could not wait until a completely new structure had been worked out ". So the Board decided that it must intensify the work on the technical evaluation of coals. The intention was that the Board should know what each particular type of coal was worth to a consumer " whose preferences are rational, and not affected by force of habit or ignorance of the alternatives ". It was, however, recognized that prices arrived at on a technical evaluation would have to be " adjusted in the light of commercial experience ".

It is in this same *Report* for 1948 that there is the first discussion of pithead *versus* delivered prices. A couple of paragraphs put some of the points on either side, and appear to leave the matter to some extent open; although the Board

" believe that the balance of advantage lies with the 'zone-delivered' scheme", there will need to be "much time and study" before it can be introduced, and its "practical implications" are therefore being examined.

In 1949, there were both a further instalment of widening the gap between the prices of the different grades of coal and of the "immense" work of classifying the many varieties of coal. The price changes of May, 1949, were the second instalment of "a new and better price structure", and involved decreases of up to 15s. a ton on the one hand, and increases of up to 13s. a ton on the other. The basis was said to be largely the technical properties of the coal. The inadequacy of technical criteria was, however, becoming more recognized. Some time the "commercial" factors would become more important and, more immediately, "strictly scientific" tests for house coals were found to be inadequate, so that grading had to be "mainly in the light of the known preferences for particular coals by consumers".

This opening out of the differentials had the incidental effect of reducing the degree of subsidization among the coalfields. Although there is by no means complete coincidence, to some extent the higher grades of coal are the more costly to win; for example, both South Wales anthracite and Durham coking coal are high-cost coals. Progress was therefore being recorded in this direction as well; but in stating that it would take time before the final goal could be attained of abolishing (or nearly abolishing) the averaging principle, the Board immediately qualifies it by taking the "several coalfields" as the units.

This *Report*, by a bare reference, also shows that the delivered-price system has won its battle against the former method of charging pithead prices. The problem is now described as that of "co-ordinating the delivered prices of coals carried to many inland markets by road, rail, canal and sea from many pits and many coalfields."

The *Report* for 1950 has a very brief treatment. It is stated that a structure which attaches to the principal groups of coal a series of prices "which will reflect the preferences of rational consumers" must be based on delivered, and not pithead, prices, so that "the consumer would pay the same price for a particular kind of coal whichever pit or district the coal came from." The discussions of earlier *Reports* are said to have represented only the "tentative views" of the Board; now there is apparently no doubt.

In the *Report* for 1951 the treatment is again cursory, in spite of there having been important developments during the year. At the very end of the year, the need for a general rise in prices (making a total rise of 40 per cent. since 1947) was used to open out the differentials a bit further, for the third time. Moreover, in the summer the Board had introduced a zone-delivered price system for household coal. The coal was classified into eight groups, according to quality, and the country divided into 60 zones, each with its own set of prices for the eight grades, to be charged regardless of the origin of the coal or the distance it has to travel. The zone prices were arrived at by averaging the railway rates over the tonnages normally supplied from the various pits to the stations within the zone.

For industrial coal, the principle of delivered prices is now firmly accepted; a highly revealing sentence states that under the system contemplated, " prices would be co-ordinated at the point of delivery as they would be in a free market ". The system has not, however, been worked out, and as an interim measure an apparatus of " coalfield adjustments " has been adopted. These are additions to the national pithead prices of any grade of coal, charged on the coal from districts which sell largely in local markets; they range from 1s. to 13s. a ton. Formerly, pithead prices used to differ from one place to another; now they are fixed nationally, according to the grade of the coal. In the absence of the " adjustments ", there would be substantial shifts in the pattern of production and consumption; consumers would seek the lowest combination of pithead price (now uniform nationally) and transport charges, and this would mean a general concentrating of the market—pits which at one time were able to offset the cost of long hauls by low pithead prices could no longer do so. The adjustments are a half-way stage to delivered prices, in that they are a rough offset to differences in transport costs.

At the moment, therefore, prices are in a transitional state. The Board publishes no general list of pithead prices, but the price to be paid by any consumer can be calculated on the basis of the technical grading of the coal and the various adjustments, some permanent and some temporary, operative at the time. The Federation of British Industries, which appears to accept the Board's policy as enshrining " sound principles " for the determination of the " real value " of each grade of coal, has published a pamphlet to show how the industrial user can work out his price. But there is a warning that this may not

be the price actually charged by the Board, for some " commercial adjustment " may be made.

VI
THE DISADVANTAGES OF THE POLICY

It is now necessary to examine in more detail why the system being adopted by the Board is a bad one. In some respects the record is good. There has been the attempt to get a better structure of relative prices. The war-time averaging processes have been condemned, and the correct principles stated, even though their application is half-hearted. It is the introduction of delivered prices which is likely to undo most of the good that might be accomplished in other directions.

Delivered prices can do harm in two main directions. First, and very simply, they destroy the advantages of good location. If transport costs are averaged, then the consumer near the source of supply loses his locational advantage, while the more distant consumer derives a benefit; there is implicit subsidization of those consumers who are supplied at high cost of transport by those who require little transport. This is recognized by the Board; when the zoning scheme for household coal was being prepared, a *national* delivered price for coal was at one time contemplated, but then it was decided that this would involve too great a degree of subsidization; so the Board avoided extremes and was content with only a mild degree of sin. While this household scheme was being worked out, the Industrial Consumers' Council issued a warning against zoning of industrial coals: " We fear that hardship might be inflicted on industrialists who were influenced by relatively low transport costs in siting their works in or near coalfields if industrial transport costs, in effect, were averaged over the whole country or even over any large areas ".[1]

There is more than hardship to existing industrialists involved. The costs which have to be met to overcome the fact of distance can be an important factor in industrial and commercial efficiency, and a system which destroys the incentive to individual producers and consumers to minimize these costs may in the long run impose a serious burden on the whole economy. We can ask what the pattern of industrial location of this country would be if this system had been in operation during the past hundred years, and our answer would not be reassuring.

[1] Annual Report for the year ended 30th June, 1951.

Secondly, there is the development of the industry itself. Reversal of the policies of 1930 and of the war years must clearly mean a considerable reorganization of the coalfields, and the Board's *Plan* is, indeed, far-reaching, with possible closing down of 350 to 400 pits (out of a total of 950) and reconstruction of another 250, over the years 1951 to 1965. The broad outlines of such a plan can be seen fairly obviously; but its further refinement will require realistic costs and prices, so that the true operational results of each unit can be clearly seen. This was largely prevented by the war-time averaging arrangements, which the Board intends to continue, though in lesser degree. By averaging transport costs, which we have seen can be at least as important as differences in production costs, the Board will introduce an additional element of unreality of considerable significance.

It might be argued that the Board's decisions are administrative, to be taken in the light of all the relevant factors, and not merely on grounds of the bankruptcy of particular pits. But this overlooks the fact that the most important bit of evidence, that of profit or loss, will not be available. Under the system contemplated by the Board, it would be perfectly possible for a pit to have a profitable market for its coal at the ruling price, which it would not have if it had to meet a price based on actual production and transport costs. It would appear to be paying its way, whereas in reality it would be receiving indirect and disguised assistance from more truly competitive pits, which, in turn, would be made to appear less profitable than they would be in a free market.

These objections are, in fact, faintly recognized in the *Report* for 1948, which admits that a system of pithead prices makes " it clear how much is being paid for the coal and how much for the transport. It makes it possible to forecast the pithead proceeds of any colliery fairly accurately", which a delivered price system does not. To put the matter bluntly, the Board announces its intention of being guided in the main by market criteria, and then goes out of its way to destroy such criteria as are available to it.

There is more to it than this, however. It has been noted that the zone prices for household coal are based on the existing pattern of supply and demand in each zone; the prices themselves will therefore have the effect of stereotyping that pattern. This is precisely why the Board should stop its plans for introducing a similar system into the industrial market, before it is too late. This static quality is a common feature of centrally-

administered price systems; not only is there no guide to change, but the mechanism by which it would normally be brought about is stultified.

In spite of certain formal differences, the system desired by the Board is akin to the basing-point method used in certain United States industries, such as steel and cement. They are industries in which transport costs may be an important element in the final price to the consumer, and this fact was ingeniously used to ensure observance of prices agreed among producers, or fixed by a price leader, and to prevent any price competition. The method had the effect, as indeed was intended, of protecting established producers from the competition of newer, and more favourably-situated, plants. A Supreme Court decision, coming after more than a quarter of a century of litigation, has recently declared the method to be contrary to the anti-trust laws; its abandonment will result in important changes in the relative position of different producers and different producing centres.

The National Coal Board has a complete monopoly of the production of coal, and its prices are in any case fixed centrally without possibility of evasion. Whether it realizes it or not, the Board is adopting a system which is among the outstanding devices used by private monopoly to protect existing producers from the threat of superior efficiency and location.

VII
THE BASES OF POLICY

It is natural to ask why the policy of the Board should have developed along these lines. This is not an easy question to answer. Many influences have clearly been at work, and even with full knowledge it would be difficult to disentangle the different threads. It is, however, possible to speculate about three elements which appear to have been important.

First, and most obviously, there is simple misunderstanding of the nature of market forces. This is perhaps characteristic more of the published expositions than of the actual day-to-day operations of the Board. The reiterated belief that the system of equal delivered prices is reproducing the pattern of a free and competitive market is simply the reverse of the truth. It is, of course, perfectly true that in a free market there will be a tendency for there to be only one price for a commodity to all consumers at the same place; this is what used to happen under the system of pithead prices. But that is entirely different from the " co-ordination of prices

at the point of delivery" by a monopoly. Equality of price in the free market comes about because only those producers who are prepared to sell at that price will be in the market, and not because an artificially equal price has been arrived at by averaging the varying conditions of different producers, some of whom would not in any case sell in the market.

At the risk of being tediously obvious, a simplified example can be used. Assume that in a free market, coal of a particular grade sells at £2 a ton at place X. This is the price because of the given state of demand and because certain pits can produce coal at a cost which is covered by £2 minus the costs of transport to X; some of them will be more distant than others, some will be able to use cheaper forms of transport than others, and so on. Those which have high transport costs will get low returns and therefore must have low production costs if they are to stay in the market. This is not at all like the situation in which it is announced that the delivered price will be £2 and that all coal will be sold at that price, no matter what it costs to produce nor where it comes from and that differences in costs will be averaged. In a free market, prices are determined by the forces of supply and demand; in the Board's system they are to be injected into the situation, with an independent existence and without any of the links which are needed to make them an integral part of the mechanism.

Moreover, it is the *process* of change which is the really important element. Suppose that there is an increase in demand. There will then be an upward pressure on prices, and this will enlarge the area from which supplies are drawn, both in regard to the level of pithead costs and the distance covered; there will still be one price (higher) in X, but an increased supply will be provided by a larger number of pits, including some which could not meet a price of £2 a ton because they were too far away or had too high costs. Or, again, a new producer might appear in the market because of greater efficiency or lower transport costs than those already there; this would tend to push down prices and again shift the whole balance of supply and demand. It is important that prices themselves change in response to changed conditions of supply and demand, and in turn react back to affect these conditions; there must be a mutually-determined equilibrium.

To repeat, this is radically different from the Board's intentions; for one thing, it will be obvious that its functioning depends partly on the fact of differences of transport costs. The Board has, in fact, confused an equilibrium which is the

normal *result* of the competitive process with the *process* itself. It is true that it wishes to reproduce some of the other results of the competitive process; in the *Plan*, it says that "the matching of the future supply of coals from the coalfields to the assumed demands can be likened to the processes of the market". Unfortunately, the Board wants to do this without having at its command the essential mechanism of freely-moving prices to which individual consumers and producers can respond. It is not easy to provide a grin without a cat.

The misunderstanding of the Board is paralleled by some of the arguments used by the defendants in the basing-point cases in the United States. In the cement case of 1921–23, for instance, it was argued that, as it is in conditions of perfect competition that there will be one price for all consumers, the fact that a consumer paid the same price for his cement whether he got it from a mill next door or from one a couple of thousand miles away was evidence, not of monopoly or collusion, but of the operation of intense competition. This argument had varying degrees of sophistication, and it was a long time before the Courts saw through it.

A second element is the interpretation of the provision in the Nationalization Act that "any undue or unreasonable preference or advantage" towards any consumer must be avoided, which seems to be interpreted in the sense that there must be only one price for each grade of coal, and that every consumer must pay the same as every other. This is one of the important reasons advanced for abandoning pithead prices and cleaving to the delivered system. But if the policies of the Board were logical, it should on this argument go the whole hog, and charge delivered prices which would be uniform for the country as a whole.

Again, however, there appears to be simple misunderstanding. To charge different prices to different users who can be supplied only at different costs because their circumstances are different, is *not* price discrimination but the very opposite. No discrimination, or preference, is in fact involved in making consumers who live a long distance from pits pay higher transport charges than those who live close at hand; it is rather the equal delivered price, with averaged transport costs, which really involves discrimination. The same can be said in regard to differences in production costs. In a free market all this, of course, is sorted out, and one price, without discrimination, is established at one place. In seeking to avoid discrimination, to ensure that the "consumer would pay the

same price for a particular kind of coal whichever pit or district the coal came from", the Board is in fact introducing new discrimination on an unprecedented scale.

The third, and perhaps most important, element lies in the simple fact that the Board's prices are administered prices and not the result of the free operation of market forces. It is inevitable that the subtle complexity and variety of a free market should be moulded by an organization of this kind into a simpler form, which can be controlled by centralized decision and which, moreover, can be left unchanged for periods long enough to enable new sets of decisions to be taken and put into effect. To the Board, the decisive argument against continuation of pithead prices seems to be that they "would be extremely complicated and hard to operate" (*Report* for 1948). The fact that this system operated successfully before ever the Board came into existence seems to have escaped notice. The Board, however, is right in believing that a centrally-administered price system must be essentially simple, and that it cannot hope to reproduce the refinements and ingenuity of a free market.

It is not, however, proving easy to work out a simple system; the world itself is a bit too complex for that. So simple a fact as that there are different forms of transport, with different charges, is providing difficulties. It is interesting to see the problem which worried the cartel, of the "unfair" advantage of pits which could use sea transport to supply the London market over those which had to use rail, appearing in a new form. Coastwise rates are additionally inconsiderate, in that they do not behave in an orderly fashion like rail charges, but "vary with the condition of the freight market". The Board is therefore still a long way from producing its new "rational" price system. Some of the present conditions of shortage, while they create difficulty, also make some things easier. Once the critical shortage disappears, then many of the Board's intentions may be swept away; in their own words, "coal prices will always be affected by changes in the supply of different sorts of coal and in the strength of the demand for them".

VIII
SOME IMPLICATIONS FOR POLICY

It is clear that some changes in policy are highly desirable. In spite of administrative difficulties, a reversal of the principle of delivered prices, and return to a system of pithead prices,

deserves urgent consideration. This would, of course, mean that there would be differing prices according to the incidence of transport costs, and the Board would therefore have to realize that this was not price discrimination. It would be better still if the Board could also revert to pithead prices based on actual costs, instead of uniform prices based on some kind of average. Uniform pithead prices and averaging of transport costs are, indeed, closely linked; it can be easily seen that the latter is a logical and practical outcome of the former.

A radical change of policy of this kind, which would involve a return to a free market comparable to that of pre-1930, could be opposed on three main grounds. First, there is the danger of temporary dislocation. It may be that this is over-estimated; it is possible to hazard a guess that for some types of coal, and in some markets, we are not very far from equilibrium at present prices. In any case, these changes are no greater than those which have already been introduced, or are contemplated, by the Board in its pursuit of the opposite policy. They are not, moreover, proposed for immediate application, but as longer-period measures, to be adopted gradually, in much the same way as the Board has taken various opportunities during the past four years to restore some of the pre-war differentials.

Secondly, there are the implications for the level of coal prices. For some time to come, prices in a free market might be higher than they are now. It is undoubted that, by continuing at least in part the war-time system, the Board has kept prices below what they would have been in a free market. It has thereby also kept down the profits of the low-cost pits, and increased the losses of the high-cost units. What is to be questioned is the assumption which is usually accepted without question, that this is a desirable state of affairs. On the one side, to keep prices down to average costs, instead of letting them rise nearer to marginal costs, does little to encourage consumers to economize in a scarce commodity produced at high marginal cost. On the other, it is just this situation of high profits for some mines, with losses for others, that is needed as the guide and mechanism of a development plan. The high profits of the most efficient collieries would be not only a guide to their growth, but also the means by which it could be financed. It is in this way, indeed, that the Board's objective of using the nation's resources to the best advantage could be most certainly achieved; its present policy, of using the economic rents of low-cost mines to subsidize both the

less efficient mines and the consumer, is more likely to result in national waste than in ultimate benefit.

Thirdly, the restoration of this amount of market freedom would involve a degree of decentralization which might be regarded as a denial of the essential purposes of nationalization. This may well prove to be the decisive argument. The purpose of nationalization is to secure uniformity, through control by a central body which can consider " the industry as a whole ", instead of leaving the pattern to be determined by the atomistic decisions of innumerable independent units. It may be asking the impossible to expect a Board charged with the tasks laid upon it by a Nationalization Act to decentralize its key decisions and operations to the extent needed for the establishment of a free market for its products. A large measure of centralized control, and therefore of false uniformity, may thus have to be accepted as part of the price of nationalization.

The future of price policy in coal has its intrinsic importance; but the experience of the Coal Board also has its moral for the other nationalized industries. In spite of the difficult situation which was inherited by the Board, its problems were in many ways easier than those which face certain of the other industries. In transport, for example, it is in " co-ordination " of prices that a solution of the problems of competition between, and the correct uses of, the different forms of transport has to be sought. There, too, we have been promised a new price structure which will resolve the many difficulties, but so far the details are entirely lacking. These problems are not solved by saying that we must have a " correct " system of prices; the ground is simply shifted, and the Transport Commission will have an even more difficult task than the Coal Board. The same could be said of the co-ordination of prices of gas and electricity. It is doubtful whether any comprehensive and coherent solutions to these problems exist in the terms in which they are posed; and even if they do, it would be idle to expect administrative organizations of the size of these bodies, already overwhelmed with the day-to-day operations of enormous businesses, to be able to find them. It can only be hoped that the grosser errors of policy will be avoided, and that sufficient flexibility and adaptability can be retained to allow at least a modicum of economic progress.

IX
POSTSCRIPT

Since the foregoing paragraphs were written, the (Ridley) Committee on the Use of Fuel Resources has published its Report (Cmd. 8647). One-half of the eight members consider that the price of coal should be based on marginal costs, whereas the other half, including the Chairman, prefer the present system of prices based on average costs to the industry. A lucid statement presents a convincing case for marginal-cost pricing; the reasons are essentially the same as those we have discussed, namely the proper criteria for the development of the industry and, with particular stress, economy on the part of the consumer. Those who wish to continue average-cost pricing do so chiefly because "coal is so important to the economy that it should be sold at the lowest price which is consistent with the National Coal Board's covering its costs." Apart from its question-begging formulation, this is in fact a weak argument which could be used with greater force on the other side. Even when supported by a series of other considerations, mostly of immediate expediency, such as the effect of higher coal prices and profits on wages, it seems that this party has the worst of the argument.

The marginal-cost party, however, does not wish to "push the argument so far as to relate price to short-run marginal costs in the present coal shortage." They fear that the immediate rise in price in a free market would be too great, hazarding a guess of £3 a ton. They therefore propose an excise duty of £1 a ton, which is their guess at the long-term gap between marginal and average costs. They do not state why they prefer an excise duty to a straightforward increase in price, but simply insist that the proceeds must be paid to the State. Is it because they dislike the idea of profits? An excise duty has disadvantages of its own, and it would have been better if the proposal could have been free from the extraneous considerations which it involves.

We are not told what the Coal Board thinks about this; that body submitted a Memorandum of Evidence which manages to ignore completely any reference to prices and price policy.

Cambridge,
September, 1952.

S. R. Dennison.

" Disinflation " to Date

By W. Manning Dacey

" The most significant change in monetary policy since the beginning of the war occurred in November, 1951, when steps were taken to give the authorities greater control over the volume of credit, helping them to bring about the measure of disinflation which the economy required."

THUS the *Economic Survey* for 1952. It is, of course, still far too early to pass any definitive judgement on the new policies. Ten months' experience of their working do, however, make it possible to attempt at least a preliminary appraisal of their effects—and it is only in the light of the results actually achieved that one can assess how significant a change the policy decisions of November last did in fact represent. The background to those decisions was, of course, a balance-of-payments crisis of appalling severity, and it is clear from official statements that it was the external crisis which provided the stimulus to action in the monetary field. A certain measure of disinflation was desired not so much for its own sake, as the means of terminating the gross social injustices inflicted on large sections of the community by the continuous inflation of the preceding twelve years; it was desired primarily because Authority seemed at last to have accepted the argument that domestic inflation has been largely responsible for the recurring crises in our external payments and that inflation may have some connection with the size of the stock of money in existence.

Now, it is clear that from the point of view of the balance of payments very considerable results have in fact been achieved under the new régime. The devastating drain on our gold reserves has been stemmed, and the very real danger of a collapse in the exchange value of the pound held at bay. What is not so clear is the extent to which the new monetary policies have contributed to that great achievement. How far has the improvement in our balance of payments been due, on the contrary, to unrelated and *ad hoc* policies such as the the import cuts (which in themselves are calculated to aggravate inflationary pressures)? How far has any lessening of inflationary pressure been due to purely fortuitous developments, such as the severe but temporary depression in the textile industries? For light on such questions one can only turn to the banking and economic statistics of the past ten months. We shall not expect statistics alone to provide

conclusive answers, but we may at least hope to discover some significance in the trends which they reveal.

* * *

So far as advances are concerned, there can be no doubt about the efficacy of the action taken. Notwithstanding the new policies, the combined advances of the clearing banks did indeed continue their upward trend until April, but that is hardly surprising when one has regard to the momentum of the 1951 expansion and the closely related fact that wholesale prices did not reach their peak until January. Since April we have seen a remarkably swift decline of close on £200 millions in four months, making a fall of £170 millions on balance since the inception of the new policies. This movement owes a great deal, of course, to the repayment of advances by the electricity industry with the aid of the recent public issue, but is none the less impressive. Nor is it by any means the full measure of the contraction in the accommodation extended by the clearing banks to the private sector of the economy. Over the same period, the volume of commercial bills in the banks' portfolios was reduced by £87 millions. Acceptances and credits extended by the banks themselves have undoubtedly also been sharply curtailed.

Over and above the remarkably prompt reversal of the trend of advances, the effect of the new policies is manifest in a striking change in their composition. As is well known, the banks were requested to give prior consideration in their lending policies to the requirements of defence, export and other essential activities such as the production of food. For statistical purposes it is obviously quite impossible to identify these favoured activities with any accuracy. Even within a particular industry one firm may be heavily engaged on defence contracts or export orders and another be working exclusively for the home market, and so qualify for different treatment. Nor is the type of activity conclusive, for the purpose for which an advance is required must also be taken into consideration; the banks are not expected to supply permanent capital even to the most favoured categories of borrowers. For purposes of a rough and ready assessment, however, it is perhaps reasonable to regard seven of the twenty-five groups into which bank advances are classified as falling within the "Essential" category, and to group the remainder into two broad divisions, "Other Trade and Industry" and "Other Borrowers" respectively.[1]

[1] See footnote to Table I for basis of this classification.

On this basis, it will be seen from Table I, the "Essential" group actually rose by £39 millions between November, 1951, and August, 1952, and by £65 millions on the year. By contrast, "Other Trade and Industry" declined by £85 millions on the year and by as much as £137 millions between November and August. Of the latter movement, £46 millions is attributable to Group 21 (public utilities other than transport) and presumably reflects for the most part the effects of the electricity issue; the remaining groups under this heading thus show a combined fall of £91 millions over the period. "Other borrowers" fell by £70 millions in the nine months. As a result, the proportion of total advances classified as "essential" rose from 20 per cent. to about 24 per cent., while loans to "other trade and industry" declined from over 43 per cent. to less than 40 per cent. The share of "other borrowers"

TABLE I

DISTRIBUTION OF BANK ADVANCES

	Aug., 1951	Nov., 1951	Aug., 1952	Change over Period: Nov., 1951, to Aug., 1952	Change over Period: Aug., 1951, to Aug., 1952
	£m.	£m.	£m.	£m.	£m.
"Essential" group	377	403	442	+ 39	+ 65
Other Trade and Industry ..	821	873	736	—137	— 85
Other Borrowers	766	740	670	— 70	— 96
TOTAL	1,964	2,016	1,848	—168	—116

As Percentage of Total

	Aug., 1951	Nov., 1951	Aug., 1952
	%	%	%
"Essential" group	19·2	20·0	24·0
Other Trade and Industry ..	41·8	43·3	39·8
Other Borrowers	39·0	36·7	36·2
TOTAL	100·0	100·0	100·0

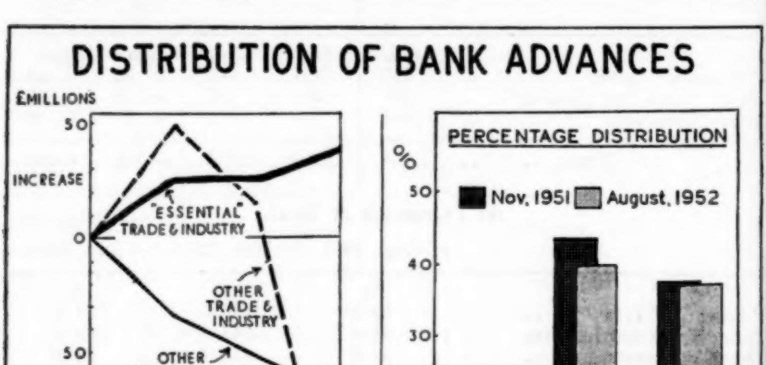
"*Essential*": 1. Coal Mining. 3. Iron, Steel and Allied Trades. 4. Non-ferrous metals. 5. Engineering, etc. 6. Shipping and Shipbuilding. 12. Chemicals. 13. Agriculture and Fishing.

Other Trade and Industry: 2. Quarrying, etc. 7. Transport and Communications. 8. Cotton. 9. Wool. 10. Other Textiles. 11. Leather and Rubber. 14. Food, Drink and Tobacco. 15. Retail Trade. 16. Entertainment. 17. Builders and Contractors. 18. Building Materials. 19. Unclassified Industry and Trade. 21. Public Utilities.

Other Borrowers: 20. Local Government Authorities. 22. Churches, Charities, etc. 23. Stockbrokers. 24. Other Financial. 25. Personal and Professional.

declined fractionally, continuing a movement in progress ever since 1946, when these groups accounted for nearly 48 per cent. of the total.

What the statistics cannot tell us is how far these impressive movements are attributable merely to the fresh requests issued to the banks in November and how far to the broader changes in the monetary sphere made at that time. Few practical bankers, if any, can believe that changes of this amplitude could have been achieved merely by a revision of the official priorities and without the assistance of the very noteworthy abatement which has taken place in the *demand* for bank accommodation from the less essential categories of borrowers. The reasons for that slackening in demand are, of course, in turn open to discussion, but there can surely be no doubt that the increase in lending rates and the marked change in the financial climate associated with the new monetary policies must have played a predominant part. On the other hand, it is clear that fresh guidance from the Chancellor, even as an isolated measure, could have been relied upon to produce *some* shift in the direction of bank lending and to exert some restraining influence on its total. To the extent that one chooses to explain the changes that have occurred by reference merely



to the new requests, then the results achieved must be credited not to the adoption of any "new" policies but to the revision and intensification of a technique—the qualitative as distinct from quantitative control of credit—already in use for many years before November, 1951.

* * *

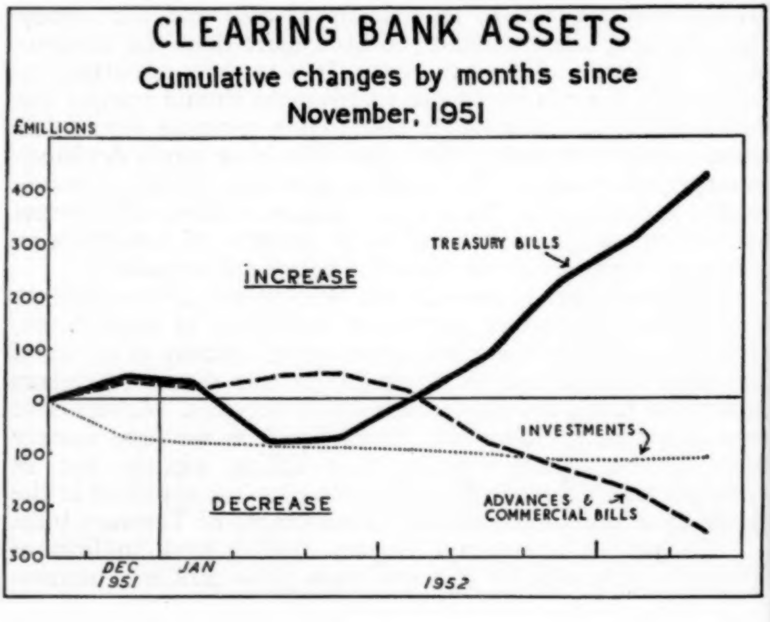
The really "significant change" in policy to which the *Economic Survey* refers was concerned neither with the total nor with the composition of bank advances *as such* but with the volume of bank deposits. By raising Bank Rate and suspending the automatic money tap against Treasury bills at ½ per cent. the authorities resumed the power, for the first time since war began, to regulate the level of bank cash reserves and therefore —given the 8 per cent. cash ratio—of bank deposits. Another way of expressing this is to say that the authorities now had it within their grasp to ensure, if they chose to use their new powers in this way, that if advances should continue to expand in spite of the new requests (as was generally thought likely in view of the rise in wholesale prices), then any such addition to advances could take place only at the expense of some other asset. Hence the importance of the issue of Serial Funding Stocks. By mopping up some £500 millions of Treasury bills held by the banks, this operation, as the *Survey* points out, brought down the ratio to deposits of cash and the money market assets, taken together, to little more than the conventional minimum of 30 per cent. It was thus calculated to ensure that if a continued rise in advances should compel the banks to reduce their other assets, this pressure would fall upon investments rather than upon the (now much depleted) money market assets. The funding operation, in other words, tended to re-establish the pre-war scissors movement between investments and advances and so to deprive an expansion in advances of any influence upon the volume of deposits.

It was natural to assume that this change alone would do a great deal to restrain any future expansion of bank credit, since for many months previously the rapid growth of advances had been the principal factor tending, under the arrangements hitherto in force, to push up the level of deposits. Matters have turned out very differently. Since April, as we have already seen, advances have actually been falling steeply, but in the meantime a fresh inflationary stimulus has appeared in the shape of an enormous increase in the supply of Treasury bills.

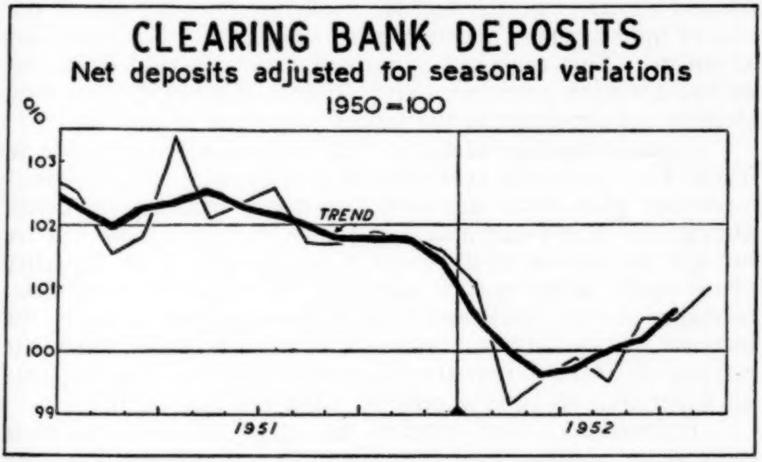
Between February and August, clearing bank holdings of Treasury bills shot up by more than £500 millions, whereas

over the corresponding months of 1951 the money market assets of the banks were reduced by £117 millions—a "swing" of well over £600 millions. Resort to Treasury bill finance on so colossal a scale cannot be explained simply by reference to the deterioration in the Budget position; various other factors —the improvement in the balance of payments, Departmental support of the electricity loan, heavy encashments of tax certificates—must also be brought into the reckoning. Nevertheless, the state of the government's current finances is sufficiently alarming. At the end of August, the revenue and expenditure returns showed an over-all deficit for the first five months of the financial year of no less than £459 millions, compared with only £160 millions at the corresponding date last year. It may well be, of course, that the remaining months of the financial year will compare more favourably; but it would be miraculous if anything like the whole of the mid-year deficit were eliminated by March 31st next, as would be necessary to realize Mr. Butler's original budget estimates. The last seven months of the 1951/2 fiscal year in fact showed an over-all surplus of no more than £11 millions.

In any event, the extremely heavy Treasury bill borrowing in the first half of the financial year has had the result that,



in spite of the wholesale contraction in credit extended to the private sector of the economy, net clearing bank deposits expanded by close on £200 millions between March and August. Movements of this kind must of course be interpreted with care, owing to the strongly seasonal pattern of deposits. Occurring in the October quarter, an expansion of this kind might conceivably be consistent with a successful policy of disinflation. Unfortunately, Lloyds Bank's index corrected for seasonal movements indicates that the movement in question did in fact represent a substantial addition to the basic volume of credit. The index (1938 = 100) touched its peak of 270·9 as early as April, 1951, and in October last was already standing 1½ per cent. below this level. During the first three months after the adoption of the new policies this downward movement was sharply accelerated and the index fell by some 3 per cent. Not only has the greater part of this contraction since been reversed; the recent trends suggest that deposits in October of this year may well prove to be fully as large as they were in October 1951.



To many, this alone would appear sufficient proof of the failure of the new policies, at any rate up to the present; but that would be to jump at a conclusion which, even if correct, could properly be reached only by a less direct route. Official statements concerning the new policies certainly seem to represent, in their general tenor, a tacit admission that the stock of money is excessive and must be reduced if inflation is to be halted; but it is difficult to find any explicit declaration to that effect. The *Survey* does indeed hail the initial

contraction in net deposits as "encouraging"; but elsewhere it merely speaks negatively of restraining "an undue expansion", or vaguely of a "measure of disinflation".

To assess the desirability of a contraction in deposits, it is useful to enquire what has been happening to the size of the money stock since pre-war days. The basic principle in any attempt to measure the liquid assets of the public is that these must be related to the current level of incomes; if incomes and the stock of money were both doubled we should regard the liquidity of the public as unchanged. The stock of money is usually defined as the volume of currency in the hands of the public together with the volume of bank deposits, but the latter item may be variously defined. Whether deposits are taken gross or net of cheques and balances makes little or no difference to the calculation. If we are seeking to measure the liquidity of the public, however, it is arguable that from the banks' indebtedness to the public (bank deposits) there ought to be deducted the indebtedness of the public to the banks: in other words, that the really significant figure is not that of total deposits, whether gross or net, but of deposits less advances. This certainly appears the more logical definition and its adoption produces a very different picture if substantial changes are occurring in the ratio of advances to deposits.

Figures corresponding to both definitions are shown in Table II. It will be seen that even according to Concept A (currency plus total deposits), sweeping creation of credit during the war years and the post-war cheap money drive brought an increase of the order of 40 per cent. in the liquidity of the public between 1938 and 1947. If we prefer to use Concept B as our yardstick, and deduct advances from deposits, the increase in liquidity was more than twice as great, since the ratio of advances to deposits fell considerably on balance (from 42·9 per cent. in 1938 to only 19·6 per cent. in 1947).

Fortunately, 1947 marked the peak of this enormous increase in the liquidity of the system. It is true that still further additions have been made to the volume of bank deposits; but money incomes have been rising even faster. In 1947, rationing and other controls were preventing the public from spending freely the surplus money which had been created; by means of these widespread restraints on expenditure the "income-velocity" of bank deposits was held down to an abnormally low level. No great prescience was needed to predict that as the controls were relaxed the income-velocity of deposits would rise, and this has in fact been happening; to some extent, the

suppressed inflation has been allowed to work itself out in active inflation, and this very process has been leading us gradually back towards a position of monetary equilibrium. The result is that by 1951 the public were only 15 per cent. more liquid, on the basis of Concept A, than in 1938. With the ratio of advances to deposits also recovering to a more normal level, the run-down in liquidity on the basis of Concept B has been considerably faster but still left the relevant index for 1951 as much as 36 per cent. higher than in 1938.

Obviously, one would not wish to claim too portentous a significance for these indices. It is not in the least suggested that such figures automatically indicate the exact measure of deflation that would be needed to restore a position of monetary equilibrium. Over a longish period, and especially a longish period which includes a major war, significant changes may well occur in the desire of the public to hold its assets in the form of money. Nevertheless, one begs leave to doubt whether

TABLE II
LIQUID ASSETS OF PUBLIC

	Currency plus Deposits* as per cent. of National Income† (Concept A)	Currency plus Deposits less Advances as per cent. of National Income† (Concept B)	Index of Liquidity	
			Concept A As per cent. of 1938	Concept B As per cent. of 1938
	%	%	%	%
1929	51·0	27·3	93	77
1930	53·8	29·5	98	83
1931	57·1	32·0	104	90
1932	59·7	36·1	108	102
1933	61·7	41·3	112	117
1934	57·5	38·1	104	108
1935	57·5	38·7	104	109
1936	57·8	38·7	105	109
1937	57·4	37·4	104	106
1938	55·1	35·4	100	100
1946	75·1	64·7	136	183
1947	77·0	64·9	140	183
1948	70·8	57·8	129	163
1949	68·0	54·5	123	154
1950	66·0	51·5	120	146
1951	63·5	48·1	115	136

* Estimated notes and coin in the hands of the public plus gross deposits of the London clearing banks (excluding the District Bank, which did not join the clearing until 1936). The picture is scarcely altered if deposits are taken net, or even if the currency circulation is omitted.

† Source: 1929–1937 inclusive, *Economic Journal*, March, 1948, article by Mr. A. R. Prest; 1938–1951, *Central Statistical Office* estimates.

any such change has been in the direction of a spontaneous *increase* in the demand for liquid assets. It is surely of some significance that the liquidity of the system, even as measured by Concept A, appears still to be considerably greater than at any time in the pre-war decade, even including 1933—a year in which the initial cheap money drive had produced a considerable expansion of credit that had not yet had time to reflect itself in an expansion of incomes. It must surely give one pause to reflect that on the basis of these figures it would require a contraction of well over £500 millions in bank deposits to bring down the liquidity of the public (even on Concept A) to the 1936 level, which was higher than that of 1938 —with a strong presumption that in the absence of such action we should expect to see a further rise of the order of £1,000 millions in money incomes even if deposits remained stable.

There is at any rate no support to be found in the statistics for the view that a sufficient " measure of disinflation " could be achieved simply by restraining an " undue expansion " in deposits or even by holding the 1951 line. On the contrary, there is a strong implication that any expansion in deposits at all would be an " undue " one and a moderate funding of deposits highly salutary. That seems clear enough, at all events, if the aim is to call an absolute halt to inflation. No doubt it might be objected that this is to select too austere an objective, that it is only a more rapid inflation than is taking place in the outside world which is likely to lead a country into serious external difficulties. As applied to the United Kingdom at this time, the argument is surely no more than a theoretical one. It would be difficult to show that even from this point of view we can " afford " any inflation at all. The terms of trade have moved sharply against us; in many other countries, and especially in the United States, inflationary tendencies have been sharply arrested since the middle of 1951; the possibility of an American recession at some time in the reasonably near future cannot lightly be dismissed. " Since 1945 ", the group of independent experts recently reported to the O.E.E.C., " the financial policy in the United Kingdom has tended to take undue risks." To gamble on a renewal of world inflation to remove the necessity for disinflation at home would be one more example of that tendency.

We may therefore take it as established that some contraction in the money supply is desirable. What has been achieved so far in this direction? In the first half of 1952 the liquid assets of the public, in the sense of currency plus total

deposits, showed a fall of less than 1 per cent. by comparison with the first half of 1951. If we look not at total deposits but at deposits less advances, the decline was as much as 4 per cent., but only for what may seem the rather paradoxical reason that the average level of advances was much *higher* in the first six months of this year than in the corresponding period of 1951. It cannot be stressed too strongly that to reduce the level of advances while leaving deposits unchanged or expanding—the position during the last few months—will not reduce but tend actually to increase the liquidity of the public. On the other hand, it is fair to recognize that to focus attention exclusively on the trend of deposits does less than justice to the effects of the new policies. Banking statistics can never provide a full measure of the supply of liquid assets, if only because we have no figures of outstanding overdraft limits, which are in many ways a complete substitute for the holding of a bank balance; and nobody would doubt that overdraft limits must have been appreciably reduced since November. Similarly, one must pay some regard to the secondary liquid assets of the public, such as tax certificates (the outstanding issue of which has declined by £83 millions on the year) and above all gilt-edged holdings, whose value has on balance fallen during the new régime.

* * *

The acid test is, of course, the state of the economy. For many years past, expenditure in this country has tended to outrun our capacity to produce, with unfortunate results of which the recurring crises in the balance of payments are merely the most spectacular. Those who have advocated a policy of disinflation have done so in the belief that by eliminating the surplus of demand over productive capacity we should effect in many directions at once a radical improvement in the health of our economy. To call a halt to the progressive deterioration in the purchasing power of the pound would not only relieve social injustices which have been straining the whole fabric of our society but help to revive the almost moribund habit of thrift. A reduction in over-all demand at home would release both finished goods for export and productive resources for the export industries, while bringing about a *spontaneous* fall in the demand for imports that would make it possible to dispense with many vexatious import restrictions. It would permit wages to rise in the essential sectors without the danger of provoking a general wages spiral, thus assisting the necessary transfer of resources

from the less essential industries while enabling the trade unions to resume their proper function of bargaining, industry by industry, for the highest wages the traffic will bear.

Merely to enumerate these objectives is to show that, whatever else may have been achieved during the past ten months, it has not been a policy of disinflation in the full or true sense. Various changes of a disinflationary character have, of course, taken place. There has been a sharp check to the growth of money incomes, a certain redistribution of the labour force between the engineering and metals group on the one hand and the consumption goods industries on the other. But while some of these changes may have been in the same *direction* as those implied by a successful policy of disinflation, they have certainly not been of the same *character*. The check to incomes and the temporary loss of employment do not have the appearance of resulting from a gentle disinflationary pressure exercised evenly over the whole of the less essential sector of the economy, as would be the case if monetary policy were the predominant influence at work. They have been unduly concentrated on the unfortunate textile industries, reflecting a sharp and spontaneous fall in consumer demand for textile products which set in long before the new monetary policies were adopted and has affected most other countries of the world. That is clear both from the record of the bank clearings (see pages 48 and 52) and of the employment figures. It is equally clear that, even if textiles are excluded, the improvement in the balance of payments owes little or nothing to any expansion in the volume of exports, the only possible basis of lasting recovery. Continued complaints of inordinately long delivery dates for exports of industrial goods testify that home demand still remains excessive. Indeed, the mere retention of many far-reaching controls over spending—the restriction of imports and forcible diversion of goods to the export market, rationing, rent restriction—is a tacit admission that in many directions home demand would expand still further if allowed to express itself freely; in other words, that an inflationary potential does still exist.

* * *

For all this, it would be rash to conclude that the new chapter in monetary policy has achieved nothing. The mere unfreezing of Bank Rate did a great deal to dissipate inflationary expectations, thus indirectly as well as directly contributing to the efficacy of the new bank lending policies, and this effect was reinforced by the initial decline in the basic volume of bank deposits. There has been a distinct change in the financial

climate. And putting it at its lowest, the sharp contraction in the volume of bank credit extended to the private sector of the economy has largely neutralized what would otherwise have been the enormous inflationary stimulus of deficit finance in the form of Treasury bill borrowing. But it is, of course, equally true to say that in recent months these Treasury bill borrowings have more than neutralized the disinflationary effects of the pressure exerted on the private sector. The attempt of the late Sir Stafford Cripps to achieve disinflation by means of a large Budget surplus was nullified by the excessive level of public expenditure for which he, as Chancellor, cannot escape responsibility. There is an obvious danger that Mr. Butler's attempt at disinflation with the aid of monetary policy may go the same way. All may yet be well, but only on certain conditions. The government must be induced not only to economize but to finance itself, if borrow it must, from the public and not from the banks. The public must be induced not only to save but to hold its savings in long-term form.

W. MANNING DACEY.

September, 1952.

Statistics: Explanatory Notes

World Dollar Supply.—From the first chart on page 49 it is evident that there has been a considerable increase since the end of the war in the dollars supplied by the U.S.A. to the rest of the world through purchases of goods and services, reaching over $15,000 millions last year. Expressed as a percentage of the U.S. gross national product, however, such payments have shown only a modest increase in recent years and even in 1951 were below the rate of about 6 per cent. ruling in the 'twenties. In terms of volume, the U.S. last year imported 35 per cent. more finished manufactures and 42 per cent. more crude materials than before the war.

Exchange Reserves.—The heavy losses of gold and dollars that we sustained in the second half of 1951 and the early months of this year have now been checked and, indeed, since April—taking U.S. aid into account—our reserves have slightly increased. Further, the total gold and dollar deficit, which in the last quarter of 1951 was running at a monthly rate of over $300 millions, had been reduced by August to well under a third of this figure.

The Sterling Area.—The first chart on page 51 shows that the sterling area as a whole now accounts for a somewhat smaller proportion of world trade than before the war, in contrast to the increased share of the U.S.A. This has been due, however, to a relative decline in U.K. trade. Excluding this country, the share of the other members of the sterling area in world trade showed a slight increase between 1938 and 1951. While our share of world gold and dollar reserves has fallen compared with pre-war, that of the U.S.A. has risen to well over half of the total—even after deducting from the U.S. gold stock other countries' dollar balances, which may be regarded as a contingent claim on America's gold reserve.

Bank Clearings.—Bank clearings for the twelve provincial centres taken together in the first eight months of this year were 10 per cent. less than in the comparable period of 1951 (first chart, page 52). As is evident from the second chart, however, this decline has been due to a marked fall in the clearings in Liverpool, Manchester, and Bradford, a reflection, no doubt, of the recession in textiles. Excluding these cities, combined clearings in the other centres have shown little change on balance.

Britain's Diet.—While, on the average, we are now eating less meat, butter and sugar than before the war, we are consuming more potatoes and drinking more milk. The fall in fish consumption between 1948 and 1950 was probably due to a number of factors, among them reduced landings of fish and, in 1950, better supplies of meat. The sharp reduction in meat consumption last year, compared with 1950, was primarily due to the trade dispute with Argentina.

Housing.—While the total number of households in England and Wales increased by over a quarter between 1931 and 1951, the largest expansion was in households of one to three persons, the number in this group rising by nearly 3 millions or by more than 50 per cent. (first chart, page 54). There was a contraction of over half a million, in contrast, in the number of larger households, of six or more persons. The greatest increase in houses has been in dwellings with four or five rooms, the tendency being for the smaller households, of up to three persons, to move into dwellings of this size.

Shipping.—Although the level of tonnage in the U.K. merchant fleet has shown relatively little change over the past thirty years, the share of the U.K. in the world total had fallen by 1951 to about a fifth, compared with a third in 1920 and a half at the beginning of the century. The U.S. fleet, in contrast, has more than doubled since the 'thirties, due to the enormous war-time shipbuilding programme. Tonnage under construction in this country, however, has shown a considerable increase since pre-war—in June this year British shipyards accounted for nearly 40 per cent. of the world total.

Raw Material Prices.—Since early this year prices in general have tended to level off after the decline from the peak levels of the spring of 1951. Some commodities, however, have shown divergent trends. Thus, sisal has fallen sharply in price since March while copper prices, in contrast, have moved upwards.

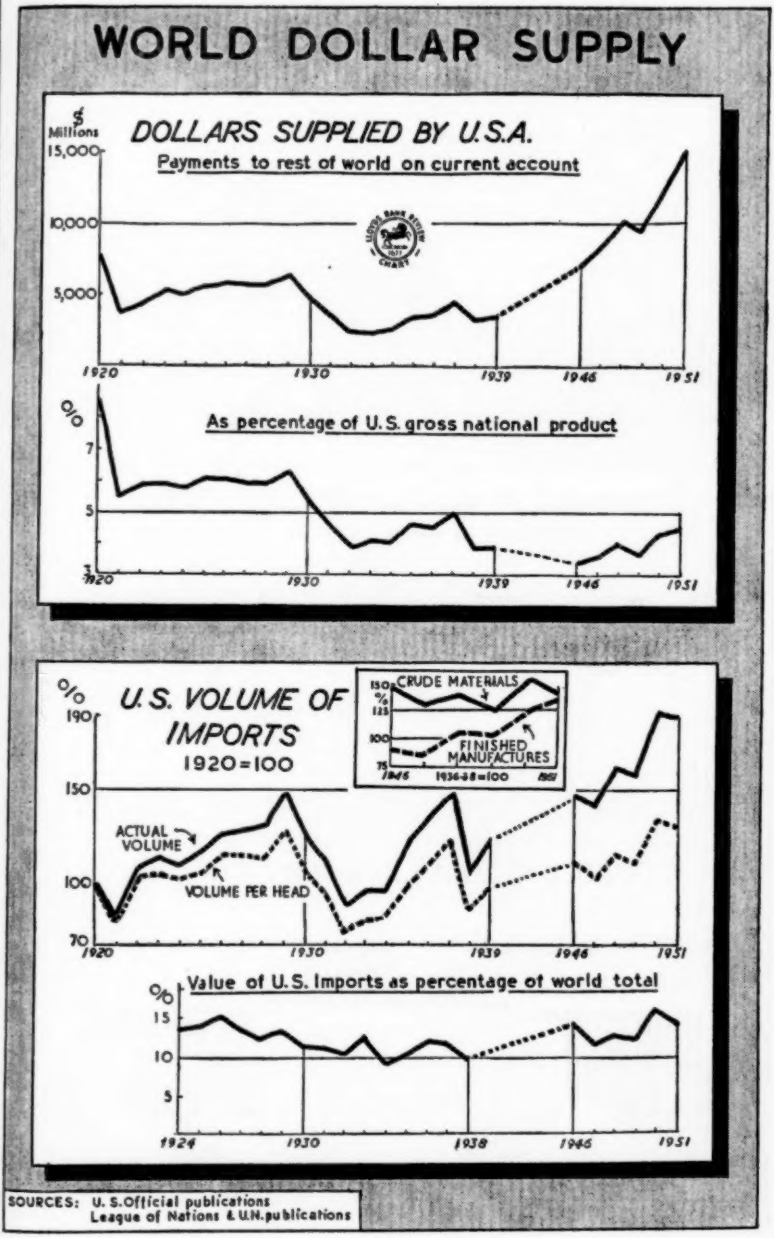
U.K. External Trade.—The first chart on page 57 shows that since the latter part of last year imports have fallen appreciably, resulting in a reduction in our import surplus. But, at the same time, the rise in our exports has also received some check—in volume, exports in the second quarter of this year were the lowest since the end of 1949.

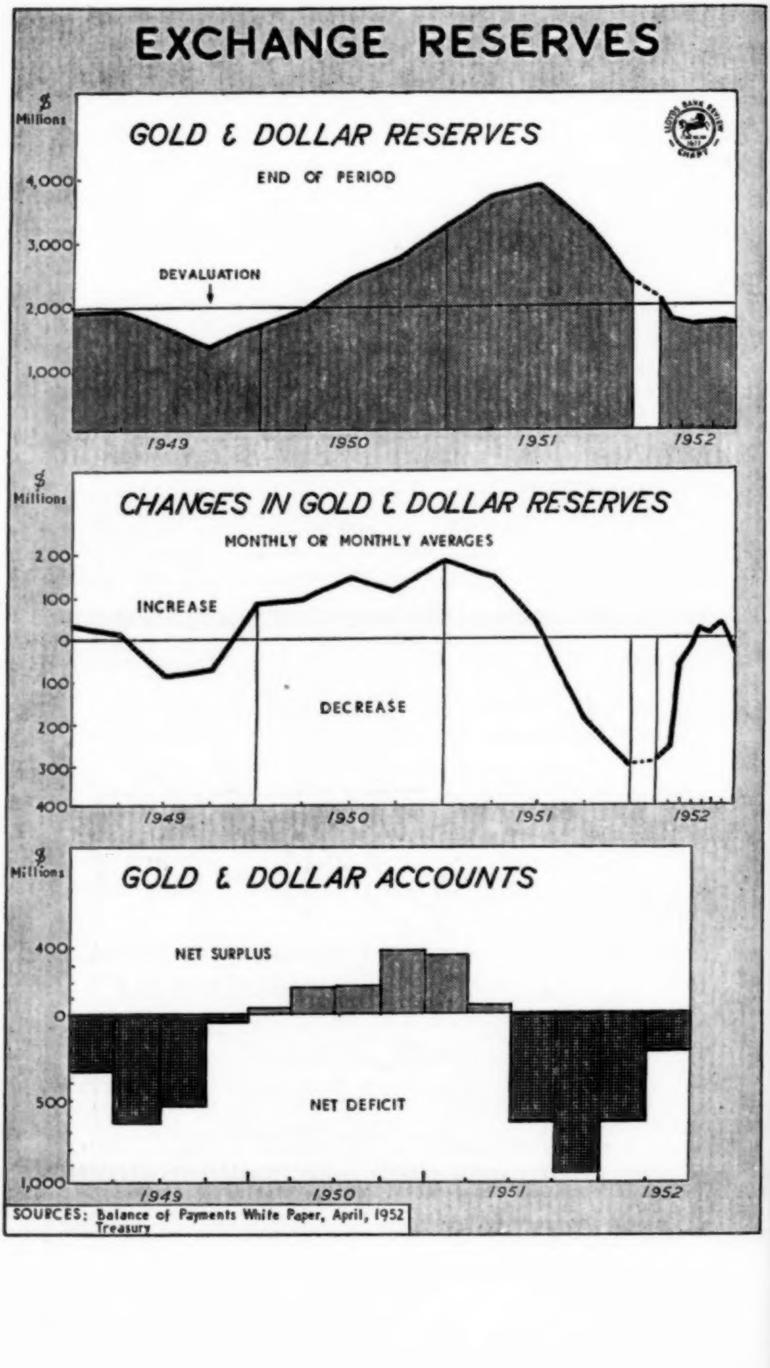
Colonial Trade.—British colonial territories in 1951 (excluding Hongkong) ran a surplus of exports over imports of nearly £250 millions, over half of which was due to the favourable trade balance of Malaya. With the dollar area alone, exports exceeded imports by a substantial margin, again due in large part to sales by Malaya.

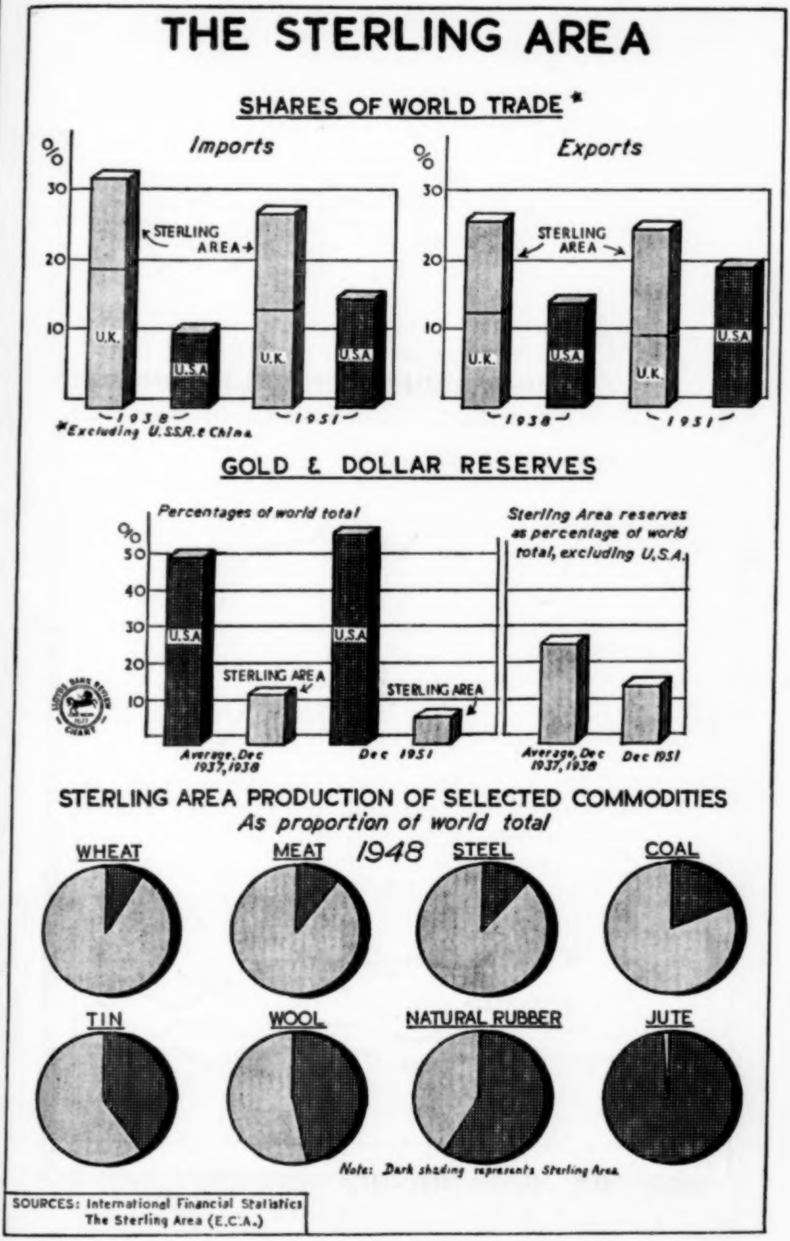
THE STERLING AREA; AN AMERICAN ANALYSIS

(H.M.S.O. Price £1 1s.)

This comprehensive, and most handsomely produced, study by the E. C. A. Mission to the United Kingdom is likely to become an invaluable source book for all those interested in the fortunes of the sterling area. The emphasis of the volume is on the development of the trade patterns of the sterling area and the economic factors which have influenced them in the post-war years, illustrated by a great wealth of statistical data. The treatment is factual throughout, nothing in the text representing any official American viewpoint.

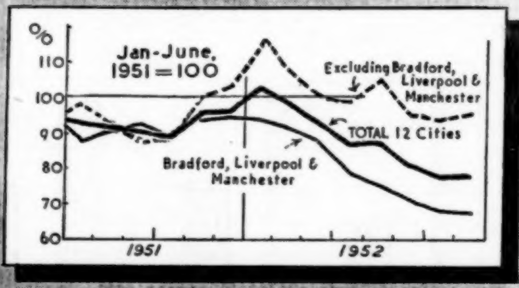

WORLD DOLLAR SUPPLY
DOLLARS SUPPLIED BY U.S.A.
Payments to rest of world on current account
$ Millions
15,000
10,000
5,000
1920
1930
1939
1946
1951
%
As percentage of U.S. gross national product
7
5
3
1920
1930
1939
1946
1951
U.S. VOLUME OF IMPORTS
1920=100
%
190
150
100
70
CRUDE MATERIALS
150
%
125
100
75
FINISHED MANUFACTURES
1946
1936-38=100
1951
ACTUAL VOLUME
VOLUME PER HEAD
1920
1930
1939
1946
1951
Value of U.S. Imports as percentage of world total
%
15
10
5
1924
1930
1938
1946
1951
SOURCES: U.S. Official publications
League of Nations & U.N. publications

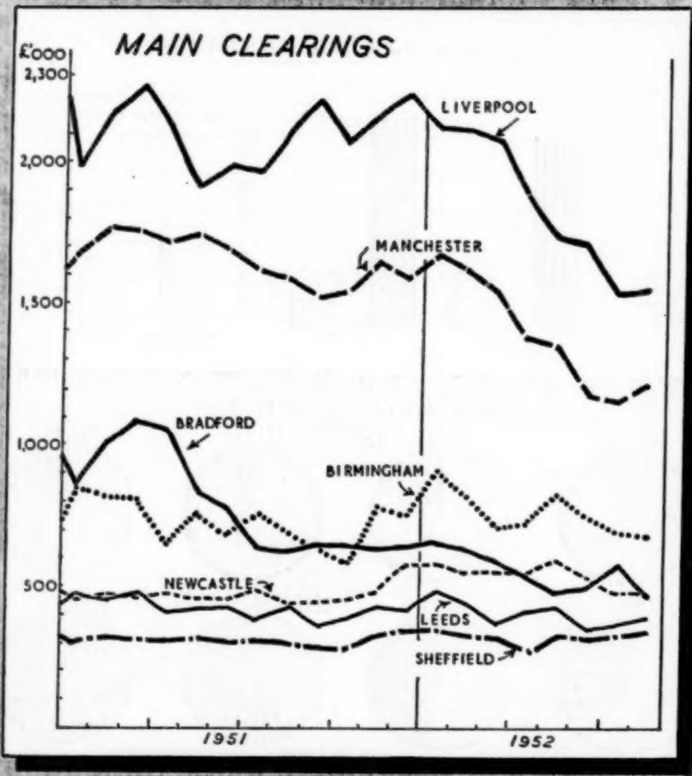

EXCHANGE RESERVES
$ Millions
GOLD & DOLLAR RESERVES
END OF PERIOD
4,000
3,000
2,000
1,000
DEVALUATION
1949
1950
1951
1952
$ Millions
CHANGES IN GOLD & DOLLAR RESERVES
MONTHLY OR MONTHLY AVERAGES
200
100
0
100
200
300
400
INCREASE
DECREASE
1949
1950
1951
1952
$ Millions
GOLD & DOLLAR ACCOUNTS
400
0
500
1,000
NET SURPLUS
NET DEFICIT
1949
1950
1951
1952
SOURCES: Balance of Payments White Paper, April, 1952
Treasury


THE STERLING AREA
SHARES OF WORLD TRADE *
Imports
Exports
%
30
20
10
STERLING AREA
U.K.
U.S.A.
1938
1951
*Excluding U.S.S.R. & China
GOLD & DOLLAR RESERVES
Percentages of world total
Sterling Area reserves as percentage of world total, excluding U.S.A.
%
50
40
30
20
10
U.S.A.
STERLING AREA
Average, Dec 1937, 1938
Dec 1951
STERLING AREA PRODUCTION OF SELECTED COMMODITIES
As proportion of world total
1948
WHEAT
MEAT
STEEL
COAL
TIN
WOOL
NATURAL RUBBER
JUTE
Note: Dark shading represents Sterling Area
SOURCES: International Financial Statistics
The Sterling Area (E.C.A.)

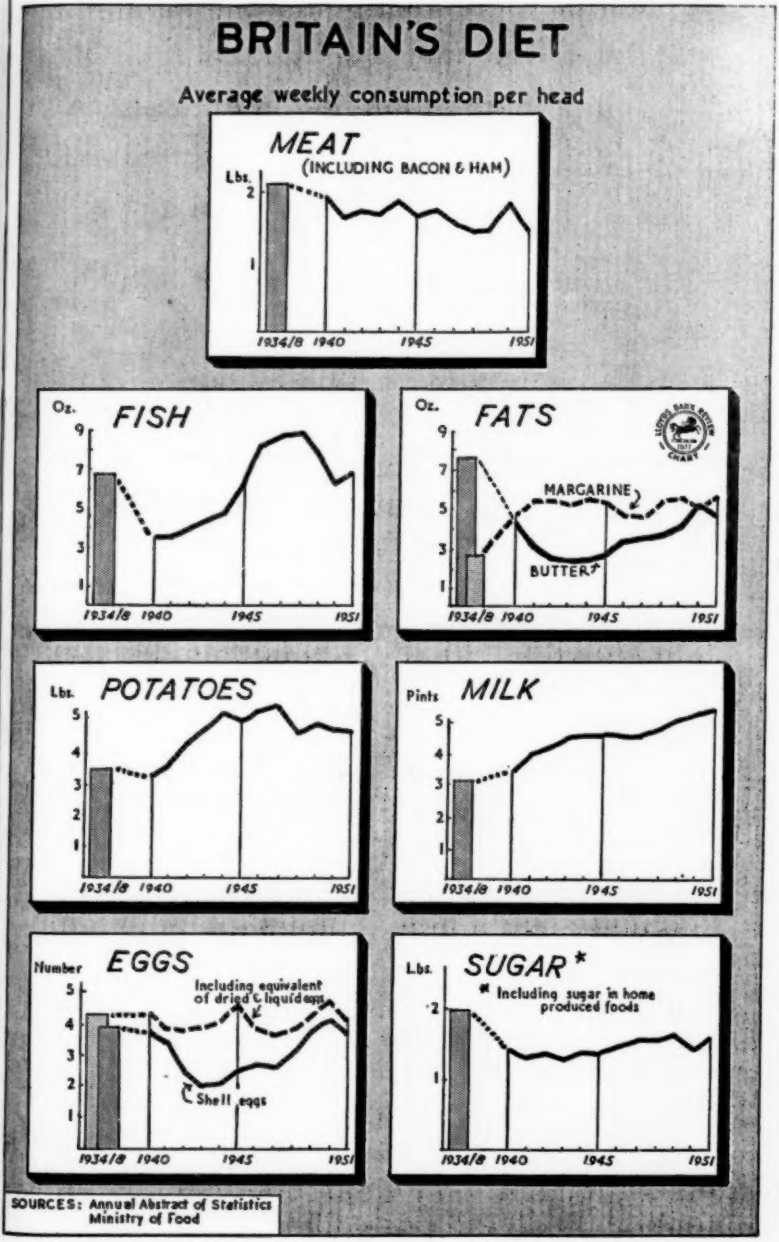
BANK CLEARINGS

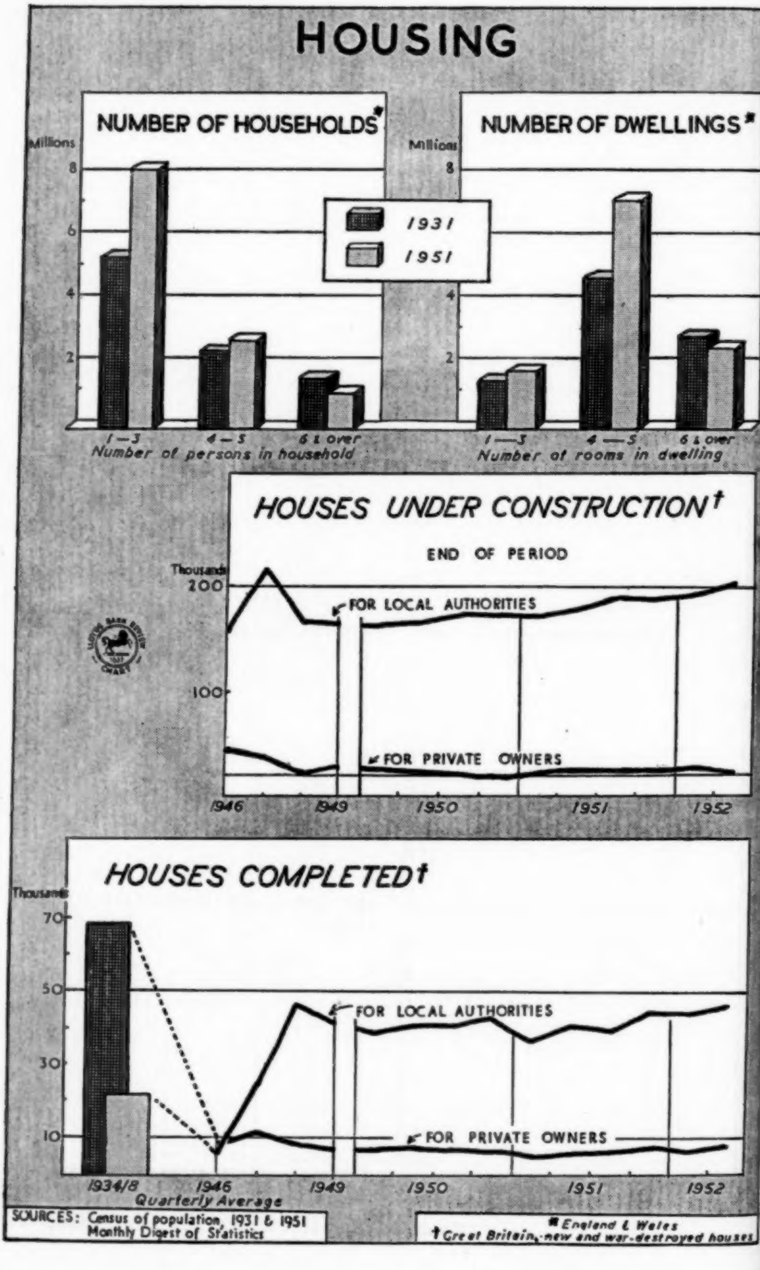
Provincial Centres, per working day



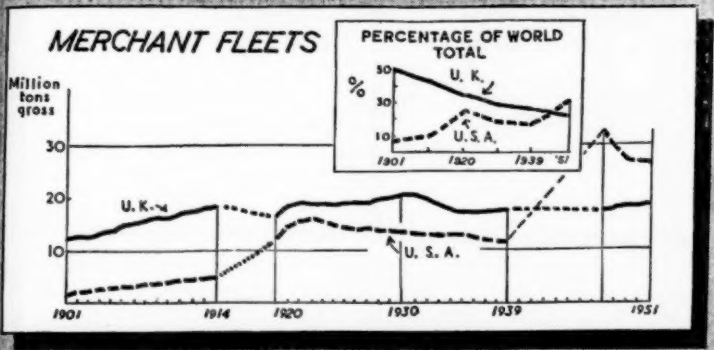


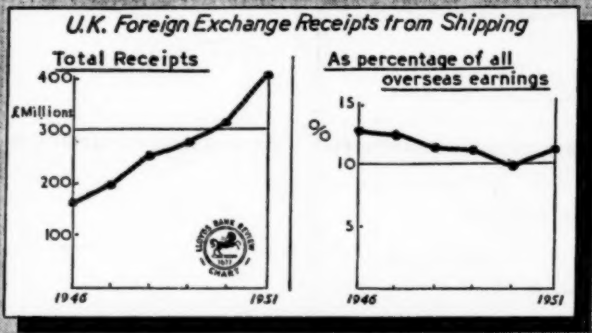
SOURCE : Bankers Clearing House

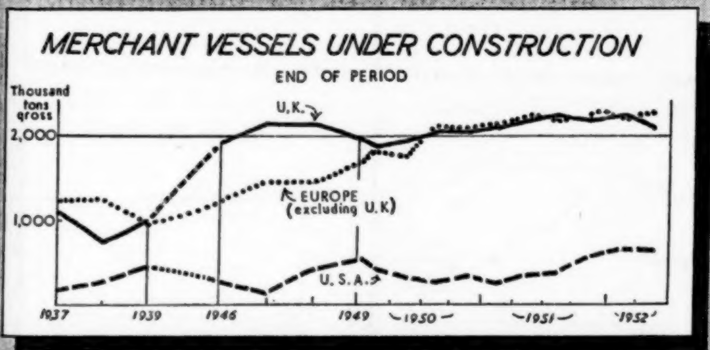

BRITAIN'S DIET
Average weekly consumption per head
MEAT
(INCLUDING BACON & HAM)
Lbs.
2
1
1934/8 1940 1945 1951
FISH
Oz.
9
7
5
3
1
1934/8 1940 1945 1951
FATS
Oz.
9
7
5
3
1
MARGARINE
BUTTER
1934/8 1940 1945 1951
POTATOES
Lbs.
5
4
3
2
1
1934/8 1940 1945 1951
MILK
Pints
5
4
3
2
1
1934/8 1940 1945 1951
EGGS
Number
5
4
3
2
1
Including equivalent of dried & liquid eggs
Shell eggs
1934/8 1940 1945 1951
SUGAR *
Lbs.
* Including sugar in home produced foods
2
1
1934/8 1940 1945 1951
SOURCES: Annual Abstract of Statistics
Ministry of Food


HOUSING
NUMBER OF HOUSEHOLDS*
Millions
8
6
4
2
1—3
4—5
6 & over
Number of persons in household
1931
1951
NUMBER OF DWELLINGS*
Millions
8
4
2
1—3
4—5
6 & over
Number of rooms in dwelling
HOUSES UNDER CONSTRUCTION†
END OF PERIOD
Thousands
200
100
FOR LOCAL AUTHORITIES
FOR PRIVATE OWNERS
1946
1949
1950
1951
1952
HOUSES COMPLETED†
Thousands
70
50
30
10
FOR LOCAL AUTHORITIES
FOR PRIVATE OWNERS
1934/8
Quarterly Average
1946
1949
1950
1951
1952
SOURCES: Census of population, 1931 & 1951
Monthly Digest of Statistics
* England & Wales
† Great Britain, new and war-destroyed houses

SHIPPING

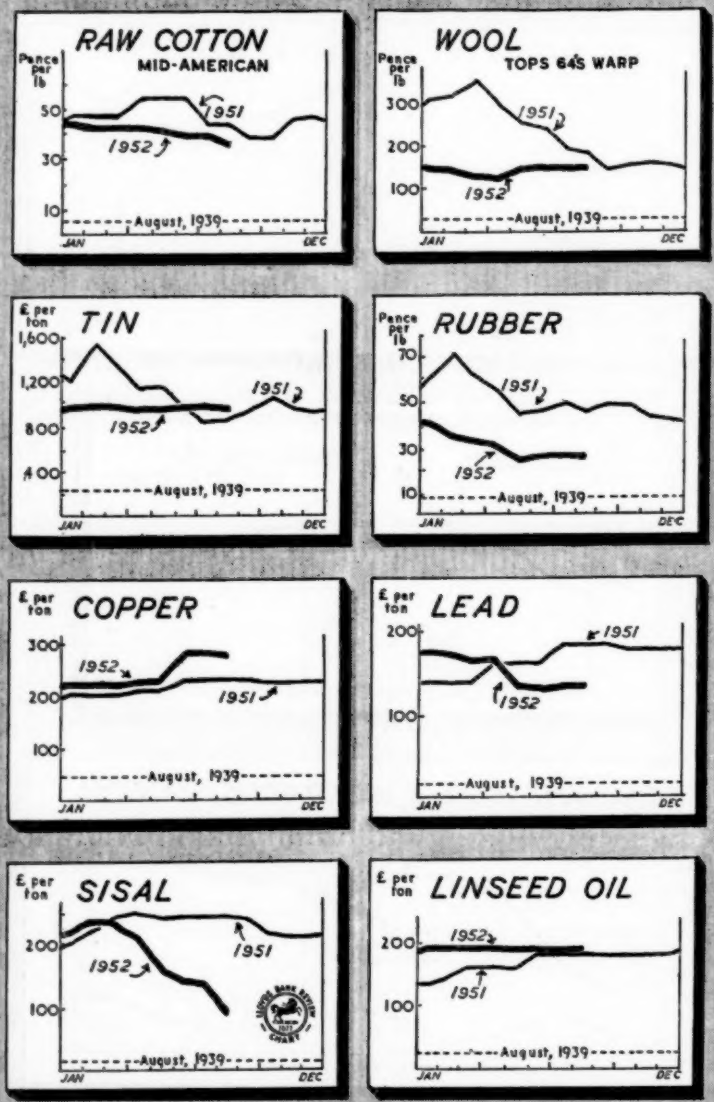






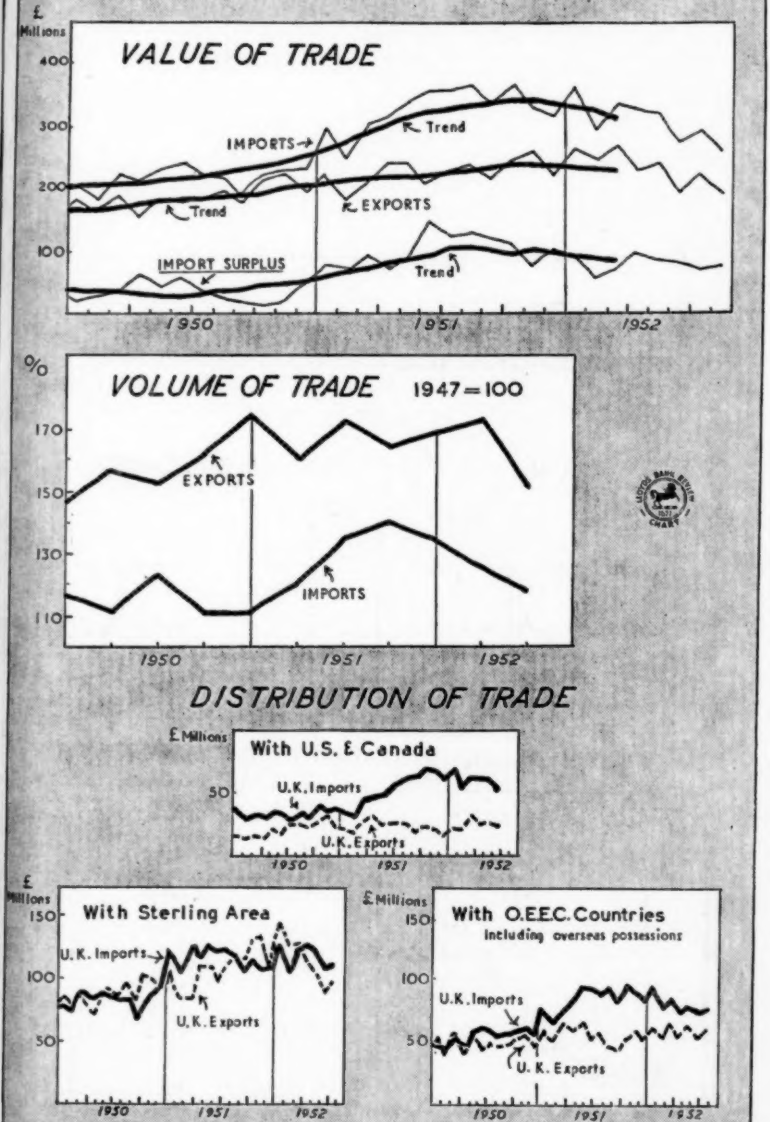
SOURCES: Lloyds' Register of Shipping
Balance of Payments White Papers

RAW MATERIAL PRICES

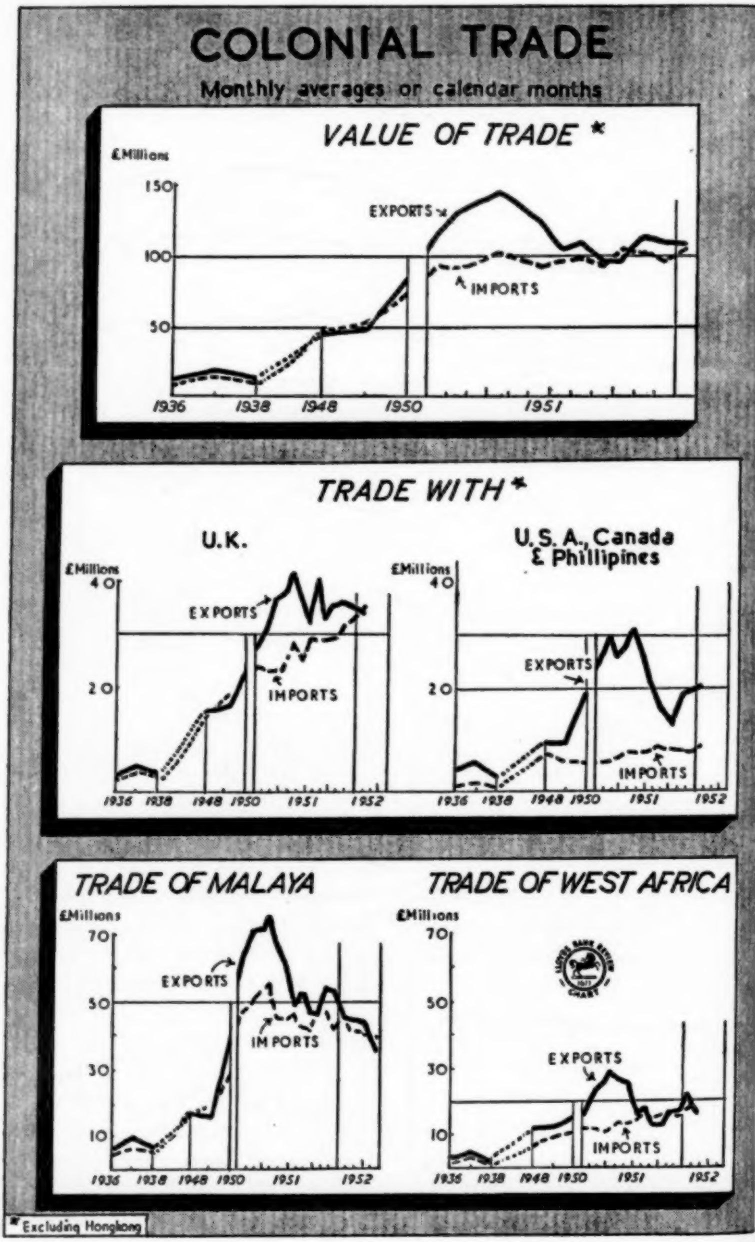


NOTE: Prices are at middle of each month.
SOURCE: Economist.

U.K. EXTERNAL TRADE



SOURCE: Report on Overseas Trade


COLONIAL TRADE
Monthly averages or calendar months
VALUE OF TRADE *
£Millions
150
100
50
EXPORTS
IMPORTS
1936
1938
1948
1950
1951
TRADE WITH *
U.K.
£Millions
40
20
EXPORTS
IMPORTS
1936
1938
1948
1950
1951
1952
U.S.A., Canada & Phillipines
£Millions
40
20
EXPORTS
IMPORTS
1936
1938
1948
1950
1951
1952
TRADE OF MALAYA
£Millions
70
50
30
10
EXPORTS
IMPORTS
1936
1938
1948
1950
1951
1952
TRADE OF WEST AFRICA
£Millions
70
50
30
10
EXPORTS
IMPORTS
1936
1938
1948
1950
1951
1952
* Excluding Hongkong